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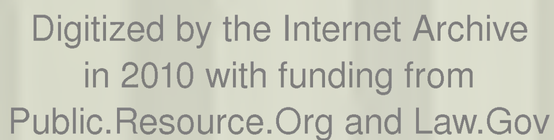
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United States Court of Appeals 3383

FOR THE NINTH CIRCUIT

SHIRLEY MOON,
Appellant,
vs.
ORVILLE FREEMAN, as Secretary of Agriculture, and COMMODITY CREDIT CORPORATION,
Appellees.

No. 21008

Appeal from a judgment of the United States District Court for the Eastern District of Washington, Northern Division

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HONORABLE CHARLES L. POWELL, *Judge*

BRIEF OF APPELLANT

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KERSHAW'S, INC.

NOV 4 1966

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BRIEF OF APPELLANT

STATEMENT OF PLEADINGS AND FACTS DISCLOSING JURISDICTION

The cause is before the Court on an Amended Complaint wherein Shirley Moon, a citizen of the United States and a resident of the Eastern District of the State of Washington is Appellant and Orville Freeman, as Secretary of Agriculture, and Commodity Credit Corporation are Appellees.

The constitutionality of provisions of the Agricultural Adjustment Act of 1964, which amended the Agricultural Adjustment Act of 1938 (7 U.S.C. 1281 et seq.) is in question.

The specific provisions of the Agricultural Adjustment Act of 1964 which are involved are as follows:

> ". . . The Secretary shall, in accordance with such regulation as he may prescribe, provide for the issuance of domestic marketing certificates for the portion of the wheat marketing allocation representing wheat used for food products for consumption in the United States and for the issuance of export marketing certificates for the portion of the wheat marketing allocation used for exports." 7 U.S.C. 1379c (a) (As amended Apr. 11, 1964, Pub. L. 88-297, Title II, sec 202 (12) - (14), 78 Stat. 180);

and

> ". . . The Secretary shall determine and proclaim for each marketing year the face value per bushel of wheat marketing certificate. . . ." 7 U.S.C. 1379c (c) (As amended Apr. 11, 1964, Pub. L. 88-297, Title II, sec 202 (12) - (14), 78 Stat. 181);

and

> ". . . During any marketing year for which a wheat marketing program is in effect, . . . all persons exporting wheat shall, prior to such export, acquire export marketing certificates equivalent to the number of bushels so exported." 7 U.S.C. 1379d (b) (As amended Apr. 11, 1964, Pub. L. 88-297, Title II, sec 202 (15) - (17), 78 Stat. 181).

Appellant, a non-complying producer and exporter, was required to purchase export marketing certificates

from the Commodity Credit Corporation and seeks to recover the sum so paid.

Appellant asserts that the above quoted portions of the 1964 Amendment to the Agricultural Adjustment Act of 1938 are unconstitutional for the reason that the export marketing certificate provisions constitute a "tax or duty" on exports and as such violate Article I, Section 9, clause 5 of the Federal Constitution, which provides as follows:

> "No tax or duty shall be laid on articles exported from any state."

Jurisdiction in the District Court of the Eastern District of Washington is based upon 28 U.S.C. 1346a (2), 28 U.S.C. 1337 and 15 U.S.C. 714b (c).

Jurisdiction in the Circuit Court of Appeals in the Ninth Circuit is based upon 28 U.S.C. 1291.

The pleadings sustaining the jurisdiction are the Complaint (Tr. pps. 1 - 6), the amended Complaint (Tr. pps. 61 - 66) and the stipulated facts (Tr. pps. 10 - 39).

STATEMENT OF THE CASE

This cause is before the Court on stipulated facts (Tr. 10 - 13). All references to facts are within the body of that stipulation.

The Appellant, a citizen of the United States, was a wheat farmer, residing in the Eastern District of the United States District Court in the State of Washington. The Appellee, ORVILLE FREEMAN, was the Secretary of Agriculture and the Appellee, COM-

MODITY CREDIT CORPORATION was a separate Corporation acting as the agent of ORVILLE FREEMAN for administration of the Agricultural Adjustment Act of 1938, as amended (7 U.S.C. 1281 et seq), hereinafter referred to as the Act, as it related to an Export Marketing Certificate program.

The Act, subsequent to the institution of the present suit was amended in part. The portion of the Act involved under the 1964 amendment are 7 U.S.C. 1379b (Pub. L. 88-297, Title II, sec 202 (10), 78 Stat. 179); 7 U.S.C. 1379c (Pub. L. 88-297, Title II, sec 202 (12)-(14), 78 Stat. 180, 181); and 7 U.S.C. 1379d (Pub. L. 88-279, Title II, sec 202 (15) - (17), 78 Stat. 181, 182). All references to the Act relate to its form and substance as existing after the 1964 amendment.

Pursuant to Sections 1379b and c of the Act the Appellees did make and promulgate regulations implementing such Act as it related to the Export Marketing Certificate Program. The regulations are a part of the Stipulation (Tr. 14-39).

The Act, provides that during any marketing year for which a certificate program is in effect all persons exporting wheat shall, prior to such export, acquire export marketing certificates equivalent to the number of bushels so exported, (7 U.S.C. 1379d (b) (ii)). Only wheat exported for non-commercial purposes and donation are excepted from this requirement. Under the 1964 program, the Secretary of Agriculture determined the face value per bushel of export certificates to be twenty-five (25c) cents per bushel, the amount as required by the Act, (7 U.S.C. 1379c (c)) by

which the level of price support for wheat accompanied by export certificates ($1.55) exceeded the level of price support for non-certfiicate wheat ($1.30). The Act provides that:

> "In order to expand international trade in wheat and wheat flour and promote equitable and stable prices therefor the Commodity Credit Corporation shall, upon the exportation from the United States of any wheat or wheat flour, make a refund to the exporter or allow him a credit against the amount payable by him for marketing certificates in such amount as the Secretary determines will make United States wheat and wheat flour generally competitive in the world market, avoid disruption of world market prices, and fulfill the international obligations of the United States." (7 U.S.C. 1379d (b).)

The amount of this refund may vary day to day.

A producer who, in 1964, diverted a specified acreage of crop land on his farm from the production of wheat to an approved conservation use, and complied with other requirements, was eligible for domestic and export certificates on his wheat acreage. (7 U.S.C. 1379c). Such a producer received domestic certificates for Fifty percentum (50%) of his farm wheat marketing allocation and export certificates for the remaining portion of the farm wheat marketing allocation devoted to wheat. The farm wheat marketing allocation is the number of bushels obtained by multiplying the normal yield by the farm acreage allotment and multiplying the resulting number of bushels by the national allocation percentage. (7 U.S.C. 1379c, Section 728.101-.103 of the Farm Wheat Certificate Program Regulations 29 F.R. 5510 (April 24, 1964), as

amended in 29 F.R. 13635 (October 6, 1964).) For 1964, the national allocation percentage was Ninety (90). Therefore, an eligible producer was given export marketing certificates on Forty-five (45) percentum of his normal yield. The Commodity Credit Corporation purchased such certificates from the producers and in turn sold the certificates to the exporters. (7 U.S.C. 1379(e)).

A producer who, in 1964, did not divert acreage from the production of wheat and comply with the other requirements specified in the Act was not eligible for export marketing certificates on any portion of his crop of wheat. (7 U.S.C. 1379c (b)).

The total wheat crop estimated to be exported in the 1964-65 marketing year was 675,000,000 bushels. The total wheat produced in 1964 was approximately 1.29 billion bushels.

The appellant did not elect to comply with the Act and was thus ineligible as a producer to receive export marketing certificates for the wheat production on his farm.

The Appellant, on January 15, 1965, contracted to sell in export wheat harvested after July 1, 1964, and exported the same to Rotterdam, The Netherlands, on or about January 26, 1965. The wheat exported did not fall within any of the exemption from the requirements of the Export Wheat Marketing Certificate Program.

The Appellant filed Form CCC-518, Report of Wheat Exported, as required by the regulations. On such form, the Appellant reported the export of

1872.4 bushels of wheat, computed his export certificate liability at Four Hundred Eleven and 93/100ths ($411.93) Dollars, computed a refund for which he was eligible at Two Hundred Forty-three and 41/100ths ($243.41) Dollars, and paid the balance of One Hundred Sixty-eight and 52/100ths ($168.52) Dollars. In this action he seeks a recovery of the One Hundred Sixty-eight and 52/100ths ($168.52) Dollars.

The Appellant was both a producer and an exporter of wheat within the meaning of the Act.

In this action, Appellant alleges that the requirement in 7 U.S.C. 1379d (b), that he purchase marketing certificates on wheat exported is a tax or duty on exports in violation of the provisions of Article I, Section 9, Clause 5 of the Constitution of the United States which states,

> "No tax or duty shall be laid on articles exported from any State."

The Appellant and Respondents respectively moved for Summary Judgment (Tr. 40-55 and 56). The District Court granted Appellees Motion and denied Appellants Motion. (Tr. 81).

SPECIFICATION OF ERRORS

The District Court erred in determining that the "Export Marketing Certificate" provisions of the Agricultural Adjustment Act of 1938, as amended, 7 U.S.C. Sec. 1281 (Secs. 1379b, 1379c and 1379d) et seq. (1964) does not constitute a "tax or duty on exports"

in contravention of Article I, Section 9, Clause 5 of the Constitution of the United States of America (Tr. 76-80) and thereby erred in entering its order granting Appellee's Motion for Summary Judgment. (Tr. 81)

OUTLINE OF ARGUMENT

Appellant's argument revolves upon the proposition that Article I, Section 9, Clause 5 of the Federal Constitution, which prohibits the imposition of a tax or duty on exports, restricts the power granted to Congress to regulate foreign Commerce in Article I, Section 8, Clause 3. The restriction operates upon Congress whether the Act challenged constitutes a revenue raising device or is designed as a regulation if, in fact, the challenged legislation imposes an economic burden upon the process of export, whether upon the article exported or the exporter.

The portion of the Act challenged in this case (7 U.S.C. 1379 a-e (1964), imposes an economic burden upon the process of export in the form of a twenty-five cent (25c) per bushel charge to be paid by the exporter for each bushel of wheat exported. The sum charged is payable to the Commodity Credit Corporation and is subject to reduction only in such amount (if any) as the Secretary of Agriculture determines shall be necessary to make United States Wheat competitive in the world market. As such the Act imposed an economic burden upon the Appellant in the sum of $168.52.

LEGISLATIVE HISTORY

The Act in question originated in the Senate and passed the Senate after having been referred to the Committee on Agriculture and Forestry. The Act thereafter was passed by the House of Representatives after being handled by the Agriculture Committee. The matter of constitutionality and potential violation of Article I, Section 9, Clause 5 as a tax or duty on exports was raised directly by Representative Thomas Curtis (Missouri) who urged that the matter should be referred to the Ways and Means Committee as revenue legislation. (Volume 110, Cong. Rec. 88th Cong. 2nd Session, p. 6132 March 24, 1964). The only response to the remarks of Mr. Curtis are those of Representative Carl Albert (Oklahoma) (110 Cong. Rec., 88th Cong. 2nd Session, p. 7309, April 8, 1964). The enactment became effective April 11, 1964.

CONSTITUTIONAL HISTORY

Article I, Section 9, Clause 5 of the Federal Constitution provides as follows:

> "No tax or duty shall be laid on articles exported from any State."

Constitutional History shows that the purpose of this clause was to serve as a limitation on the power of Congress to regulate foreign commerce, as well as to serve as a limitation on the general power of Congress to raise revenue.

The idea of a restriction on the imposition of a tax or duty on exports appeared in an early draft of the Committee on Detail in two areas: The first provided

that among the legislative powers should be the power to raise revenue by taxation, except that no tax should be imposed on exports (*Farrand,* The Records of the Federal Convention, Vol. II, p. 142); and, secondly as an exception to the power to regulate commerce it was provided that there should be no duty on exports (*Farrand,* supra, page 143).

Among Mr. Wilson's (of Pennsylvania) papers the draft in the Committee on Detail showed language that:

> "No tax or duty shall be laid by the Legislature on articles exported from any State; . . ." (*Farrand,* supra, pps. 168, 169.)

This language was the language of the draft reported out of the Committee on Detail on August 6, 1787. (*Farrand,* supra, p. 183.) The Committee on Style modified the language to its present form by eliminating the words "by the legislature." (*Farrand,* supra, p. 596.)

The proponents of the clause were concerned not only with the question of revenue but asserted a need for a definite restriction on the power of Congress to interfere with or regulate commerce involving exports. The Southern States, which were the exporting States, wanted protection for their export trade and asserted that the power to impose a tax or duty on an export could give the Federal Government the power to wholly dominate, and ruin if it sought, the business of a particular commercial locale. (*Farrand,* supra, pps. 305-308, 359, 365.) The urgency of the feeling of some members of the Southern delegations to provide

a restriction relating to taxation of exports, is reflected by their attempt to directly couple this restriction to the clause granting the general power of taxation to Congress. These members did not wish to risk granting the general power to tax without immediately, in the same Article, restricting its use on exports. (*Farrand,* supra, p. 305.)

When the prohibition against taxation or imposition of duties on exports came on for general debate in the Convention, the sweeping effect of the Article as intended by the Framers is illustrated by not only the debate (*Farrand,* supra, pps. 359-365) but by several attempts made to modify its structure.

The opponents of this Section, including James Madison, argued that the power to regulate exports, through a tax, was a necessary national power for a variety of purposes, including the necessity for:

> "Procuring equitable regulations from other nations" (*Farrand,* supra, p. 361).

Mr. Wilson stated that to pass favorably upon the prohibition of taxing exports:

> "Is to take from the Common Government half the regulation of trade." (*Farrand,* supra, p. 362.)
>
> "It was his (Mr. Wilson's) opinion that a power over exports might be more effectual than that over imports in obtaining beneficial treaties of commerce." (*Farrand,* supra, p. 362.)

In order that the power to regulate the export trade might be retained with the Central Government two amendments were proposed to the draft of the Committee on Detail.

(1) Mr. Clymer (of Pennsylvania) moved that the words "for the purpose of revenue" be inserted after the word "duty" in the draft. His stated purpose in moving for this amendment was that the taxation of exports for the regulation of trade should be permissible. (*Farrand,* supra, p. 363.) The attempted amendment was defeated. (*Farrand,* supra, p. 363.)

(2) Mr. Madison (as a lesser evil than a total prohibition of a tax or duty on exports) moved to amend the clause by inserting after it the words "unless by consent of two-thirds of the legislature." This attempted amendment also failed. (*Farrand,* supra, p. 363.)

The proponents of the prohibition of imposition of taxes or duties on exports set forth a variety of reasons for seeking to prevent this power from being placed in the hands of the Federal Government. Among these arguments was one which might be appropriate in this case, i.e.:

> "It might be made use of to compel the States to comply with the will of the General Government, and to grant it any new powers which might be demanded . . ." (*Farrand,* supra, p. 363).

It appears that the States were jealous of their export markets during the full course of the Convention and that it was the intent of the Convention that the Congress be restrained from in any way interfering with access of the citizens of the several States to foreign markets. The prohibition against a tax or duty on exports then, it would reasonably seem, prohibits not only the raising of revenue through this source, but also any attempt to regulate foreign or domestic markets through this same device.

James Madison (who professed a need for a power to lay duties and tax exports in order that the Central Government could adequately regulate trade) in his notes on the Constitutional Convention shows discussion of this precise question by numerous members of the convention and illustrates the determination of the convention that the clause in question prohibited the laying of taxes or duties either for purposes of revenue or for purposes of regulation. *Madison* "Journal of the Constitutional Convention" Vol. II, pps. 572-576. Madison in his notes, reflected his feelings for the need of a power to lay taxes or duties saying:

> ". . . A proper regulation of exports may, and probably will, be necessary hereafter and for the same purposes as the regulation of imports, viz, for revenues, domestic manufactures and procuring equitable regulations from other nations." *Madison* 'Journal of the Constitutional Convention' Vol. II, p. 574.

The Constitutional Convention, as reflected above, defined the breadth of the clause in question by stating that a tax or duty on exports should not be used for either revenue raising or regulatory purposes. This question was placed squarely before the Convention as set forth previously in this brief (*Farrand,* supra, p. 363). We can give significance to the action of the Convention in defeating attempted amendments to the clause in question only by interpreting that clause as constituting not merely a limitation on the powers of taxation, but also a limitation on the power of Congress to regulate foreign commerce under Article I, Section 8, Clause 3. This has been the interpretation in the past.

TAX OR DUTY

The terms "tax or duty" are illustrative of the broad prohibition intended by the Framers of the Constitution. A question as to the precise meaning of each word was raised in the Convention (*Farrand,* The Records of the Federal Convention, Vol. II, p. 305) but was not answered. The terms "tax or duty" are, however, separate and distinct, and both are prohibited.

The term duty entails commercial useage and seemingly is identified as a system for commercial regulation.

University of Illinois v. U.S. (1933) 289 U.S. 48, 77 L.Ed. 1025, 53 S. Ct. 509 speaks of duties as being a "regulatory device" as well as a "taxing device."

Mr. Storey in Commentaries on the Constitution Vol. II, sec. 1088 (1873) speaks of duties as a common means of exercising the power to regulate commerce.

Pollock v. Farmers Loan & Trust Co. 39 L. Ed. 1108, 15 S. Ct. 912, 158 U.S. 601 (1895) speaks of "duties" in antithesis to direct "taxes" and cites the writings of Mr. Hamilton as contradistinguishing duties from taxes; which generally speaking are considered as revenue raising devices for the regular support of government.

> "In its most usual signification this word (duty) is the synonym of imposts or customs; but it is sometimes used in a broader sense as including all manners of taxes, charges or governmental impositions." Blacks Law Dictionary, Third Edition, page 631.

The term duties certainly must be considered as broadening (rather than restricting) the language of Article I, Section 9, Clause 5.

TEXT INTERPRETATION

Constitutional authorities have consistently interpreted Article I, Section 9, Clause 5, as limiting the power of Congress to impose any form of economic burden on exports and, in effect, that the Clause in question constitutes a limitation on the power of taxation as well as the power to regulate foreign commerce.

Mr. Joseph Storey in his "Commentaries on the Constitution of the United States" makes these precise observations:

> "No. 1013 The next clause in the Constitution is: 'No tax or duty shall be laid on articles exported from any State' . . . "
>
> "No. 1014 The obvious object of these provisions is to prevent any possibility of applying the power to lay taxes, *or regulate commerce,* injuriously to the interests of any State, so as to favor or aid another. . . ." (Emphasis added)
>
> ". . . The burden of such a tax would, of course, be very unequally distributed. The power is, therefore, wholly taken away to intermeddle with the subject of exports. . ."
>
> "No. 1015 The first part of the clause was reported in the first draft of the Constitution. But it did not pass without opposition and several attempts were made to amend it, as by inserting after the word 'duty' the words 'for the purpose of revenue,' and by inserting at the end of it 'unless by consent of two-thirds of the legislature,' both of which propositions were negatived. It then passed by a vote of seven States against four.

> Subsequently the remaining parts of the clause were proposed by report of a committee, and they appear to have been adopted without objection. Upon the whole, the wisdom and sound policy of this restriction cannot admit of reasonable doubt; not so much that the powers of the general government were likely to be abused, as that the constitutional prohibition would allay jealousies and confirm confidence. The prohibition extends not only to exports, but to the exporter. Congress can no more rightfully tax one than the other." *Storey, Joseph; Commentaries on the Constitution of the United States,* Boston, Little, Brown and Company 1873, Vol. I, p. 712.

See also *Burdick,* "The Law of the American Constitution" (1922) p. 194, Sec. 81 which analyzes Article I, Section 9, Clause 5 of the Constitution as an explicit constitutional limitation on the power of Congress; and, *Willoughby* on the Constitution, Vol. II p. 694 (2d ed). *Bernard C. Gavit,* Professor of Law at Indiana University in "The Commerce Clause of the United States Constitution" (1932) discusses limitation on the power of Congress to act under the Commerce Clause. He concludes that among the limitations imposed on Congress' power to regulate Commerce under the Commerce Clause are those imposed by Article I, Section 9, Clause 5 of the Constitution (p. 202, Sec. 98).

COURT INTERPRETATION

The Constitutional provision in question has been consistently interpreted to mean that Congress shall not hinder or obstruct the process of exports, and that domestic producers should have access to foreign markets without the imposition of an economic burden

specifically because of their participation in the export market.

The present case is in direct conflict with that policy. Under the Act in question Appellant was required as a condition of participating in the export market, to obtain certificates equivalent to the number of bushels exported. Appellant was required to pay One Hundred Sixty-eight and 52/100ths ($168.52) Dollars to sell his produce abroad.

The power to regulate foreign commerce (Article I, Section 8, Clause 3) is not so broad as to override all other provisions of the Constitution. *Adair vs. United States,* 208 U.S. 161, 28 S. Ct. 277, 52 L. Ed. 436 (1907); *Gibbons vs. Ogden,* 22 U.S. 1, 9 Wheat 1, 6 L. Ed. 23 (1824). One of the limitations imposed on the power to regulate foreign commerce is Article I, Section 9, Clause 5. *Secretary of Agriculture v. Roig Ref. Co.,* 338 U.S. 604, 94 L. Ed. 381, 70 S. Ct. 403 (1950); *Burdick,* "The Law of the American Constitution" (1922) p. 194, sec. 81; *Gavit,* "The Commerce Clause of the American Constitution" (1932) p. 202, sec. 98; *Willoughby,* "On the Constitution" (2 Ed.) Vol. II, p. 694; *Storey* "On the Constitution" (5th Ed.) Vol. I, sec. 1014.

While this precise type of tax or duty has not been placed directly before the Supreme Court, the general prohibition by the Constitution of any interference with the export process, through placement of an economic burden (of whatever size) on either the article exported, the exporter or the process of export has been well (and consistently) voiced by the Court. This

national policy is clearly expressed in *Fairbanks v. United States,* 181 U.S. 283, 45 L. Ed. 862, 21 S. Ct. 648 (1900) where a statute had imposed a charge of ten cents (10c) on any

> "bill of lading . . . for any goods, merchandise, or effects, to be exported from any port or place in the United States to any foreign place . . ."

The Government contended that this did not constitute a tax or duty *on the article exported* and that the scope of the legislation was to impose a duty on a document not the article. The Court struck the Act down as unconstitutional. It stated:

> "The requirement of the Constitution is that exports should be free from any governmental burden. The language is, 'no tax or duty'. Whether such provision is or is not wise is a question of policy with which the Courts have nothing to do. We know historically that it was one of the compromises which entered into and made possible the adoption of the Constitution. *It is a restriction* on the power of Congress; and as, in accordance with the rules heretofore noticed, the grants of powers should be so construed as to give full efficacy to those powers and enable Congress to use such means as it deems necessary to carry them into effect, so in like manner a *restriction should be enforced in accordance with its letter and spirit, and no legislation can be tolerated which, although it may not conflict with the letter, destroys the spirit and purpose of the restriction imposed.* If, for instance, Congress may place a stamp duty of Ten cents (10c) on bills of lading on goods to be exported, it is because it has power to so do; and if it has power to impose this amount of stamp duty it has like power to impose any sum in the way of stamp duty which it sees fit. And it needs but a moments reflection to show that thereby it can effectually place

a burden on exports as though it placed a tax directly upon the Article exported. It can for purposes of revenue, receive just as much as though it placed a duty directly upon the articles, *and it can just as fully restrict the free exportation which was one of the purposes of the Constitution.*"

". . . the question of power is not to be determined by the amount of the burden attempted to be cast. The constitutional language is, 'no tax or duty.' "

". . . *the purpose of the restriction is that exportation * * * all exportation — shall be free from national burden.* This intent, though obvious from the language of the clause itself, is reinforced by the fact that in the Constitutional convention Mr. Clymer moved to insert after the words 'duty' the words 'for the purpose of revenue,' but the motion was voted down. *So it is clear that the framers of the Constitution intended, not merely that exports should not be made a source of revenue to the national government, but that the national government should put nothing in the way of burden upon such exports. If all exports must be free from national tax or duty, such freedom requires, not simply an omission of a tax on the articles exported, but also a freedom from any tax which directly burdens the exportation; . . .*" (Emphasis added)

The case of *Brown v. Maryland* 12 Wheat 419, 7 U.S. 262, 6 L. Ed. 678, (1837), while relating to Article I, Section 10, Clause 2, is quite closely in point. In that case the State of Maryland required all importers of certain foreign articles to take out a license before they were authorized to sell the imported goods. It was there held that the license, although in the form of a tax on the person for the privilege of

selling was in fact a tax on imports and that the mode of imposing it merely varied the form without varying the substance. Chief Justice Marshall stated:

> "All must perceive that a tax on the sale of an article imported only for sale is a tax on the article itself. . . . so a tax on the occupation of an importer is, in like manner, a tax on importation. It must add to the price of the article, and be paid by the consumer or by the importer himself, in like manner as a direct duty on the article itself would be made. This the State has not the right to do, because it is prohibited by the Constitution."

In *Thames & Mersey Marine Insurance Company, Ltd. v. United States* 59 L. Ed. 821, 237 U.S. 19, 35 S. Ct. 496 (1914) the plaintiffs were engaged in writing insurance on merchandise in export in accordance with general export trade custom. The insurance was written as, or shortly after, goods are in actual export. A tax was imposed directly on the insurance policy. The economic impact of an increased cost imposed on the export process merely because it involved an export (as opposed to purely domestic) product led the Court to conclude that the tax violated Article I, Section 9, Clause 5. The Court does not become involved with the issue of revenue or non-revenue or regulatory devices. It holds that the imposition of an *economic burden* on the process of export contravenes the Constitutional mandate.

> *"Is the tax upon such policies so directly and closely related to 'the process of exporting' that the tax is in substance a tax upon the exportation and hence within the constitutional prohibition*:
> ". . . the rise in rates for insurance as immediately affects exporting as an increase in freight

> rates, and *the taxation of policies insuring cargoes during their transit to foreign ports is as much a burden on exporting as if it were laid on the charter parties, the bills of lading, or the goods themselves. Such taxation does not deal with preliminaries, or with distinct or separable subjects; the tax falls upon the exporting process.*" (Emphasis added.)

In *United States v. Hvoslef*, 237 U.S. 1, 35 S. Ct. 459, 59 L. Ed. 813 (1916) the Court was dealing with an enactment wherein a stamp tax was imposed directly upon the occupation of operating as a charter party in foreign commerce. The Charter Parties operated exclusively between United States and foreign ports. The tax was struck down as contravening Article I, Section 9, Clause 5 of the Constitution. The Court held that the purpose of this Clause was to prevent obstruction of the export process, not merely to prevent raising revenue from this source.

> "The charters were for the exportation; they related to it exclusively; they served no other purpose. A tax on these charter parties was in substance a tax on the exportation; and a tax on the exportation is a tax on the exports."

The Court then proceeded using language most appropriate to the present case:

> ". . . *This constitutional freedom, however, plainly involves more than mere exemptions from taxes or duties which are laid specifically upon the goods themselves. If it meant no more than that, the obstruction to exportation which it was the purpose to prevent could readily be set up by legislation nominally conforming to the constitutional restriction, but in effect overriding it.* It was the clear intent of the framers of the Constitution that *the process of exporting the products*

> *of a state, the goods, chattels, and property of the people of the several states, should not be obstructed or hindered by any burden of taxation.* 'Miller, Const. p. 592.' . . ."

In *A. G. Spalding & Bros. v. Edwards* 262 U.S. 66, 67 L. Ed. 865, 43 S. Ct. 485 (1923) the Court held that a tax on

> "All baseball bats . . . balls of all kinds . . . sold by the manufacturer . . ."

was a tax on exports where the manufacturer contracted through a commission merchant. The sole purpose of the transaction was for export and the question to be decided was whether the "sale" was a "step" in export. The tax was on the sale and was held to violate the constitution prohibitions of Article I, Section 9, Clause 5.

> "The very act that passed the title (the sale), and that would have incurred the tax had the transaction been domestic, committed the goods to the carrier that was to take them across the sea for the purpose of export, and with the direction to the foreign port upon the goods. The expected and accomplished effect of the act was to start them for that port. The fact that further acts were to be done before the goods would get to the sea does not matter so long as they were only the regular steps toward the contemplated result."

Under the Agricultural Act of 1938, as amended, (7 U.S.C. 1379d (b)) it is provided that:

> "(ii) all persons exporting wheat shall, prior to such export, acquire export marketing certificates equivalent to the number of bushels so exported."

It is thereafter provided that the Commodity Credit Corporation shall allow a refund to the exporter, or a credit against the amount payable for Certificates, in such amount as the Secretary of Agriculture determines will make United States wheat and wheat flour generally competitive in the world market, avoid disruption of world prices and fulfill the international obligations of the United States. The price of each certificate is Twenty-five cents (25c) which sum must be paid by the exporter to participate in the export trade. Without question, as a pure matter of economics, this cost must be passed on, as a part of the purchase price, to the foreign buyer. This can only mean that the foreign buyer pays a price of Twenty-five cents (25c) per bushel (less the current subsidy) in excess of the price receivable by, and quotable to the producer. The complying producer then receives Twenty-five cents (25c) per bushel on Forty-five percent (45%) of his normal production (not his actual production) from the Commodity Credit Corporation as a "bonus" for "cooperating" with the Federal Government. The non-complying producer is wholly deprived of access to the Twenty-five cent (25c), as a "penalty" for "not cooperating" with the Federal Government. The amount of this penalty may vary from day to day depending on the amount of "subsidy" for export established by the Secretary for a particular day under the provisions of Section 1379d (b) previously paraphrased. The cost of the export certificate also may be increased each year.

It is difficult to evaluate whether this is a direct impost on the goods, or upon the exporter. Certainly

it is a circumstance which must be fulfilled as a condition of entering the export market, and thus falls as a direct burden on the "process of exporting," acting as an obstruction as directly as the tax on charter parties in *United States v. Hvoslef,* supra; or as directly as a stamp tax on a bill of lading in *Fairbanks v. United States,* supra; or a tax on the occupation of importing, *Brown v. Maryland,* supra.

CONCLUSION

Appellant urges that the Constitutional and Decisional History, and authoritive interpretation of Article I, Section 9, Clause 5 lead to the unquestionable conclusion that the imposition of *any* "tax or duty" resulting in an economic burden on the process of exporting (whether the article exported or the exporter) is prohibited, whether the "tax or duty" is intended as a revenue or a regulatory measure. As such, Article I, Section 9, Clause 5 is a restriction on the power granted to Congress in Article I, Section 8, Clause 3. The following sections of the Agricultural Adjustment Act of 1964 should be declared unconstitutional, to-wit: 7 U.S.C. 1379c (a) (As amended Apr. 11, 1964, Pub. L. 88-297, Title II Sec. 202 (12-14), 78 Stat. 180, 181); 7 U.S.C. 1379c (C) (As amended Apr. 11, 1964, Pub. L. 88-297, Title II, Sec. 202 (12) - (14), 78 Stat. 180, 181); 7 U.S.C. 1379d (b) (As amended Apr. 11, 1964, Pub. L. 88-297, Title II, Sec. 202 (15) - (17); 78 Stat. 181, 182), insofar as said sections require the purchase of export marketing certificates as a condition of exporting wheat.

The Order granting Appellee's Motion for Summary Judgment (Tr. 81) should be reversed and an Order should be entered granting Appellant's Motion for Summary Judgment and granting Appellant Judgment in the sum of $168.52 and costs.

DATED, Colfax, Washington
July 6, 1966

Respectfully submitted,

WESLEY A. NUXOLL
Attorney for Appellant

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

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Attorney for Appellant

No. 21008

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

SHIRLEY MOON,

Appellant

v.

ORVILLE FREEMAN, as Secretary of Agriculture, and COMMODITY CREDIT CORPORATION,

Appellees

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF WASHINGTON

BRIEF OF THE APPELLEES

FILED

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Appellees

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF WASHINGTON

BRIEF OF THE APPELLEES

JURISDICTION

Jurisdiction in this Court is based upon 28 U.S.C. 1291.

COUNTERSTATEMENT OF THE CASE

Appellee believes that a more complete statement of the wheat program, as authorized by Congress, may be helpful to the Court in resolving the issue before it - hence this counterstatement.

The genesis of the Wheat Marketing Allocation Program is in §§ 324 and 325 of the Food and Agriculture Act of 1962 (76 Stat. 605, 626-631), which amends, in certain respects, the Agricultural Adjustment Act of 1938, as amended (7 U. S. C. s 1281 et seq.), and the Agricultural Act of 1949, as amended (7 U. S. C. § 1421 et seq.). The legislative finding was made, in this enactment in

1962, that:

> "Wheat, in addition to being a basic food, is one of the great export crops of American agriculture and its production for domestic consumption and for export is necessary to the maintenance of a sound national economy and to the general welfare. The movement of wheat from producer to consumer, in the form of the commodity or any of the products thereof, is preponderantly in interstate and foreign commerce. Unreasonably low prices of wheat to producers impair their purchasing power for nonagricultural products and place them in a position of serious disparity with other industrial groups. The conditions affecting the production of wheat are such that without Federal assistance, producers cannot effectively prevent disastrously low prices for wheat. It is necessary, in order to assist wheat producers in obtaining fair prices, to regulate the price of wheat used for domestic food and for exports in the manner provided in this subtitle [i.e., §§ 1379a-1379j of Title 7, U. S. C.]."

The Wheat Marketing Allocation Program - as provided for in 1962 - was a part of a regulatory plan for mandatory acreage allotments and marketing quotas. 7 U. S. C. 1958 ed. (Supp. IV) § 1281 et seq. The statute required a referendum among wheat farmers to determine whether at least two-thirds of those voting in the referendum favored the imposition of quotas. 7 U. S. C. 1958 ed. (Supp. IV) § 1336. The Secretary determined, on the basis of the referendum, that "[s]ince more than one-third of those voting opposed quotas, wheat marketing quotas will not be in effect for the 1964-65 marketing year." 28 F.R. 6039.

Further statutory amendments were recommended by the President "to check a drastic decline in producer income from the 1964 crop."

110 Cong. Rec. 1462. It was estimated that in the absence of additional legislation wheat producers would receive "between $500 million and $700 million less in 1964 than they did in 1963." A "certificate program on a voluntary basis" was recommended. "The law," said the President, "should be designed to, first, raise the income of wheat growers substantially above what it would be in the absence of new legislation; second, avoid increases in budgetary costs; third, maintain the price of wheat at a level which will not increase the price of bread to the consumer, and fourth, enable the United States to discharge its responsibilities and realize the benefits of the International Wheat Agreement." *Ibid.*

Thereupon the Congress enacted the Agricultural Act of 1964 (78 Stat. 173, 178-183) further amending the Agricultural Adjustment Act of 1938, as amended, and the Agricultural Act of 1949, as amended. A "wheat marketing allocation program as provided in this subtitle [*i.e.*, §§ 1379a-1379j of Title 7, U. S. C.] shall be in effect for the marketing years for the 1964 and 1965 crops." 78 Stat. at 179, 7 U. S. C. § 1379b.

The Wheat Allocation Program provided for production controls on a voluntary basis; and to encourage producers to participate in the program those agreeing to follow the quota system were entitled to receive marketing certificates valued at the rate of 70 cents per bushel for a portion of the crop which it was estimated would

be used for food consumption in the United States, and 25 cents per bushel for a certain portion of the crop which it was estimated would be exported. To finance this program the processors were required to buy certificates at the rate of 70 cents per bushel for all wheat processed into food, and 25 cents per bushel for all wheat to be exported. However whereas payments to producers were based on normal production for the acreage allotments the payments by processors and exporters were based on the number of bushels of wheat actually processed for food consumption or actuall purchased for export.[1] (7 U. S. C. 1379b,c,d(b)). If the Department's estimates proved substantially correct and if most American farmers participated in the program the payments to producers would be financed by receipts from the processors.

There is one significant factor which cannot be overstressed - the tentative nature of the exporter's payments. He had to buy the certificates at the 25 cent rate, but to make certain that this pav ment would not increase the price of American wheat above the world price, thus depriving American farmers of an international market Congress provided:

1/ Exporters engaged in the sale of wheat abroad pay 25 cents for each bushel of wheat exported. There is no provision for the purchase of export certificates in connection with the sale abroad of flour. However, the processor must buy 70 cent certificates on all wheat processed into flour used for food, regardless of its ultimate destination. This cost is passed on to the exporter, who, is entitled to a refund from Commodity Credit Corporation to the extent necessary to make his flour competitive in the world market. (7 U. S. C. 1379d(b))

> In order to expand international trade in wheat and wheat flour and promote equitable and stable prices therefor the Commodity Credit Corporation shall, upon the exportation from the United States of any wheat or wheat flour, make a refund to the exporter or allow him a credit against the amount payable by him for marketing certificates, in such amount as the Secretary determines will make United States wheat and wheat flour generally competitive in the world market, avoid disruption of world market prices, and fulfill the international obligations of the United States. (1379d(b).

As a consequence of this section the actual payments made by an exporter fluctuated from day to day with the world price. As noted in the affidavit of Mr. Godfrey, Administrator of Agricultural Stabilization and Conservation Service, the exporters may have had to pay nothing - indeed they were frequently the recipients of an actual cash subsidy - if such were necessary to make American wheat competitive in the world markets. (R. 49)

In the case at bar the appellant is an exporter who paid $411.93 for certificates in the marketing year 1964-1965. He received a statutory refund of $243.41 to bring his wheat in line with the world price, and sues to recover the difference - $168.52, contending that the statute authorizing the Secretary to require processors to purchase certificates for wheat to be exported is in violation of Art. 1, Sec. 9, clause 5 of the Constitution.

Decision of the District Court

Both parties, after agreeing upon a stipulation of fact, filed motions for summary judgment. In view of the attack upon the constitutionality of a statute a three-judge court was convened and heard argument on the motions for summary judgment. It then ruled

that since the only relief available to the plaintiff was a money judgment, the matter did not require the attention of a three-judge court, and the matter was remanded to the District Court for decision. (245 F. Supp. 837, 838-839, E.D. Wash.). The District Court (Judge Powell was a member of the three-judge panel) granted the Government's motion for summary judgment.

Constitutional Provisions, Statutes and Regulations Involved

Constitutional Provisions:

Art. 1, Sec. 9, Clause 5 - No tax or duty shall be laid on articles exported from any State.

Art. 1, Sec. 8, Clause 3 - Congress shall have the power "To regulate Commerce with Foreign Nations, and among the several States, and with the Indian Tribes."

Statutory Provisions Involved:

The complete text of the statutory provisions involved will be found at 7 U.S.C. 1379(a) to (j), 76 Stat. 626-629, as amended, 78 Stat. 180-181.

The particular provisions being challenged are:

Marketing Certificates:

The Secretary shall, in accordance with such regulation as he may prescribe, provide for the issuance of domestic marketing certificates for the portion of the wheat marketing allocation representing wheat used for food products for consumption in the United States and for the issuance of export marketing certificates for the portion of the wheat marketing allocation used for exports. 78 Stat. at 180, 7 U.S.C. § 1379(a).

Marketing Restrictions:

(i) all persons engaged in the processing of wheat into food products shall, prior to marketing any such food product or removing such food product

for sale or consumption, acquire domestic marketing certificates equivalent to the number of bushels of wheat contained in such product and (ii) all persons exporting wheat shall, prior to such export, acquire export marketing certificates equivalent to the number of bushels so exported. In order to expand international trade in wheat and wheat flour and promote equitable and stable prices therefor the Commodity Credit Corporation shall, upon the exportation from the United States of any wheat or wheat flour, make a refund to the exporter or allow him a credit against the amount payable by him for marketing certificates, in such amount as the Secretary determines will make United States wheat and wheat flour generally competitive in the world market, avoid disruption of world market prices, and fulfill the international obligations of the United States." 78 Stat. at 181, 7 U. S. C. § 1379d(b).

The regulations involved herein are:

> 7 CFR Par. 778.5(a) which requires exporters to "acquire and surrender certificates to CCC... for wheat so exported..." at a price of 25 cents per bushel.
>
> 7 CFR Par. 778.6 which requires Commodity Credit Corporation (CCC) to make "refund to the exporter or allow him a credit against the amount payable by him for certificates in such amount as CCC determines will make the United States wheat generally competitive in the world market, avoid disruption of world market prices and fulfill the international obligations of the United States."

The Issue

Whether the requirements for wheat export marketing certificates as provided in §§ 324 and 325 of the Food and Agriculture

Act of 1962 (76 Stat. 605, 626-631, 7 U.S.C. 1379d) and in §§ 202 and 203 of the Agricultural Act of 1964 (78 Stat. 173, 178-183) - amending the Agricultural Adjustment Act of 1938, as amended (7 U.S § 1281 _et seq._) and the Agricultural Act of 1949, as amended (7 U.S § 1421 _et seq._) - constituted[2/] a "Tax or Duty * * * laid on Articl exported from any State" in contravention of Art. I, § 9, clause 5 of the Constitution.

SUMMARY OF ARGUMENT

1. A tax or duty is a revenue producing measure exacted to co the expenses of government. The income from certificates sold to exporters is not used to defray the expenses of government but to finance the purchase of certificates from the producers, and is kep in a special fund in Treasury. Hence, the certificate charge is no a tax or duty within the intendment of the Constitution.

2. The Certificate charge is a valid exercise by Congress of power under the Commerce clause. The Wheat Allocation Program, of which the certificate charge to exporters is but one feature, is designed to stabilize wheat prices and farm income. It is a regulatory measure, and the fact that some revenue may be produced as an incident to the regulation does not serve to classify the Act as a taxing statute.

2/ The statute has since been modified to eliminate the initial fixed price of 25 cents per certificate. Now the exporter pays to CCC or receives from CCC, determined on a daily basis, the amoun which will make American wheat competitive in the world market. 79 Stat. 1187, 1202-1206, 7 U.S.C. Supp. I §§ 1379b, 1379c, 1379d, 1379e, 1379g, 1379i, and 1445a. These statutory changes effectuate by the Food and Agriculture Act of 1965 relate primarily to the program for the 1966 marketing year and thereafter, and hence do not affect the pending case.

3. The certificate charge does not burden exports, but on he contrary is a benefit to the exporter since it serves to tabilize world prices, and is part of a program which guarantees he exporter a competitive position in the international market.

ARGUMENT

I. THE CHARGE OF 25 CENTS PER BUSHEL OF WHEAT EXPORTED IS NOT A "TAX" OR "DUTY".

Taxes and duties are compulsory exactions, revenue producing easures, collected and used for the general operations of governent. United States v. LaFranca, 282 U.S. 568, 572 (1930), Lipke . Lederer, 259 U.S. 557, 561-562 (1921). As was stated in United tates v. Butler, 297 U.S. 1, 61 (1935): "A tax, in the general nderstanding of the term, and as used in the Constitution, signifies n exaction for the support of government. The word has never been hought to connote the expropriation of money from one group for the enefit of another."

In the instant action payments made by an exporter for the urpose of defraying subsidies to farmers cannot be properly termed tax or duty. On the contrary, here as in Rodgers v. United States, 32 U. S. 371, 374 (1947) the statutory plan[37] is not a "revenue aising device," and "unlike a tax, it does not rest on the basic

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/ In the Rodgers case the statute provided for cotton quotas, with enalties assessed against producers who marketed in excess of their uotas.

necessity of the Government to collect a carefully estimated sum of money by a particular date in order to meet its anticipated expenditures."

Furthermore, in the instant case the money derived from the sale of the certificates did not go into a general fund to help defray the expenses of government, but went into a special fund in Treasury and was used to finance the purchase of certificates from the producers and for other CCC outlays.[4/]

It was held in the Head Money Cases, 112 U.S. 580, 595-596 (1884) that when a monetary exaction - imposed pursuant to the commerce clause - is deposited in a special fund in the Treasury to be used only in connection with the program enacted by Congress pursuant to the commerce clause, the payment thus required by the statute is not a tax or duty although "within a loose and more extended sense than was used in the Constitution" it may be called a tax.

Congressional Intent

Although Congressional intent concerning constitutionality of a statute is not conclusive it is entitled to judicial respect.

Here, there was little discussion by Congress concerning the

4/ Despite income from the sale of export certificates receipts CCC has operated at a net loss for many years, its last net realized gain occurring in 1949. (R. 54-55). The Commodity Credit Corporat[ion] is authorized by its charter to use in the conduct of its business all of its funds and other assets. 15 U. S. C. § 714f.

onstitutionality of the pending bill, in fact only two direct eferences. Congressman Thomas Curtis of Missouri stated:

> "Section 202(16) also authorizes the Secretary of Agriculture to require any person who wishes to export U.S. wheat to pay a tax to the U.S. Government at an amount which he determines. He estimates that amount at 25 cents per bushel. Our wheat exports could run as high as 800 million bushels. Using the Secretary's estimate, this empowers him to raise approximately $200 million worth of revenue. Article I, Section 9 of the Constitution of the United States states (inter alia): "No tax or duty shall be laid on articles exported from any State."
>
> In the past we have rarely had difficulty in understanding this clear prohibition against export taxes. Since we are now supposed to be having an all-out drive to expand U.S. exports, some may feel it is appropriate to test again the constitutionality of a tax levied on exports. Certainly I do not intend to debate the wisdom or constitutionality of this provision at this time, but again I suggest that the Ways and Means Committee should at least have the opportunity to review the proposal."
> Volume 110, Cong. Rec. Part 5, 88th Cong. 2nd Session, page 6132.

Congressman Carl Albert of Oklahoma, stated (110 Congresional Record, p. 7309, April 8, 1964):

> Finally, the distinction between provisions to "raise revenue" in the constitutional sense, and others has been well defined by the courts. The construction of this limitation -- article I, section 7 -- is practically well settled by the uniform action of Congress. According to that construction it "has been confined to bills to levy taxes in the strict sense of the word, and has not been held to extend to bills for other purposes which incidentally create revenue." Story on the Constitution (sec. 880, U.S. v. Norton, 91 U.S. 566, 569 (October 1875 term))

In all events it is evident that Congress did not consider the legislation to be a tax measure. That part of the Act relating to the wheat certificate program originated in the Senate, not the House, as would be required for revenue measures. It was handled in the House by the Agricultural Committee not the Ways and Means Committee, as would have been the case had the bill been a revenue measure; and likewise in the Senate the bill was handled by the Agricultural and Forestry Committee rather than by the Finance Committee.

Throughout the discussion[5/] the emphasis was on international commitments rather than on revenue. Price support through loans in the previous year had been pegged at $1.82. Price support in the 1964 marketing year through loans was to be $1.30. (R 46). If world prices remained above $1.30, and export certificates were not required, the exporters would get a real windfall, and possibly disrupt the world market.[6/] The export certificate was the Congressional answer.

5/ See 110 Cong. Rec. 3985, 4104, 4105, 4140, 4343, 4345, 4476, and Hearings before the Committee on Agriculture, House of Rep., 87th Cong. 2nd Sess. on H.R. 10010, Serial AA, Part 1, pp. 171-172, Hearings before the Subcommittee on Wheat of the Committee on Agriculture, House of Rep., 88th Cong. 2nd Sess., Serial HH, Part 2, pp. 207-208, Hearings before Senate Committee on Agriculture and Forestry, 88th Cong. 2nd Sess. on S. 1581, 1617, 2258, 2357, 2492, pp. 32, 38, 41, 171-172.

6/ A return of the certificate payments to exporters would result in a windfall since the cost has naturally been passed on to the foreign buyers.

The Committee on Agriculture and Forestry reported as follows:

> * * * the purpose of requiring certificates on wheat and wheat products exported is not to obtain revenue, but solely to regulate the price at which such products are exported and eliminate the possibility of windfall profits * * *." Sen. Report No. 874, 88th Cong., 2nd Sess., p. 33.

A Case in Point

In Morrison Milling Co., et al. v. Freeman, No. 19794 and Jational Biscuit Co., et al. v. United States, No. 19795, in the Jnited States Court of Appeals, District of Columbia, wheat processors attacked regulations (under the same Wheat Allocation 'rogram) which required them to pay 70 cents per bushel of wheat, t being plaintiffs' contention that the statute only required them o pay for that portion of the wheat which became flour (about 72%). 'hey argued that the Act was a revenue measure and should be strictly construed against the government. In rejecting that argument, the Court of Appeals said in its opinion filed on July 18, 1966, that 'the purpose of the statute appears to be to regulate the price of heat for the benefit of the grower, and the federal power relied ipon is the Commerce Clause." Slip opinion, p. 8, fn. 3. "The ill was not handled in either chamber [of Congress] as a tax; and he revenue raised is for the achievement of a regulatory purpose ind not to contribute to the general funds of the Treasury." Ibid.

From the foregoing discussion it seems reasonably clear that he sale of export certificates to exporters did not in any contitutional sense impose a tax or duty, since the statute in question

did not purport to be a revenue measure, and since in the final analysis the exact amount of the payment depended not on Congress but on international wheat prices.

II. THE CERTIFICATES HERE INVOLVED WERE A PROPER EXERCISE OF THE CONGRESSIONAL POWER TO REGULATE COMMERCE.

The Constitution grants to Congress the power to regulate interstate and foreign commerce. Art. 1, Sec. 8, Clause 3. In determining whether a statute is covered by the taxing or commerce clauses of the Constitution the basic factor is the Congressional objective.[7/] In Rodgers v. United States, 138 F. 2d 992, C.A. 6 (1943) a statute imposing a penalty of 3 cents a pound on excess cotton was attacked, and the Court in upholding the statute said, p. 994:

> "The test to be applied is to view the objects and purposes of the statute as a whole and if from such examination it is concluded that revenue is the primary purpose and regulation merely incidental the imposition is a tax and is controlled by the taxing provisions of the Constitution. Conversely, if regulation is the primary purpose of the statute the mere fact that incidentally revenue is also obtained does not make the imposition a tax, but a sanction imposed for the purpose of making effective the Congressional enactment."

7/ The wisdom of Federal regulation, the need for the regulation, and the effectiveness of the regulation are questions for Congress not the courts. Northern Securities Co. v. United States, 193 U.S 197, 350 (1903); Arizona v. California, 283 U.S. 423, 455-457 (193 American Power Co. v. Securities and Exchange Comm'n., 329 U.S. 90 106-107 (1942); Secretary of Agriculture v. Central Roig Co., 338 U.S. 604, 606, fn. 1 (1949).

Whether a statute is regulatory in nature or intended to raise revenue is not to be determined by isolating and construing one particular provision. Its purpose is to be ascertained by examination of the entire statute and the occasion and circumstances of its use. Helvering v. Stockholms etc. Bank, 293 U. S. 84, 93- (1934). "The language of an act is, of course, the fundamental guide to legislative meaning and purpose, but it is the language of the act as a whole that is to be read and not the words of a section or provision in isolation * * *." Elizabeth Arden Sales Corp. v. Gus Blass Co., 150 F. 2d 988, 992-993, C.A. 8 (1945), certiorari denied, 326 U. S. 773. Also see: Richards v. United States, 369 U. S. 1, 11 (1961); Labor Board v. Lion Oil Co., 352 U. S. 282, 288 (1956); Mastro Plastics Corp. v. Labor Board, 350 U.S. 270, 285 (1955)

And Congress in exercising its power to regulate interstate or foreign commerce may impose economic burdens and regulate prices. Groves v. Slaughter, 15 Pet. 449, 505 (1841); Wickard v. Filburn, 317 U.S. 111 (1942). Also see United States v. Rock Royal Corp., 307 U.S. 533, 569-571 (1938); Sunshine Anthracite Coal Co. v. Adkins, 310 U.S. 381 (1940), the Head Money Cases, supra. United States v. Stangland, 242 Fed. 2d 843, 848, C.A. 7 (1957). For the power of Congress under the commerce clause "is as broad as the economic needs of the Nation." American Power Co. v. Securities and Exchange Com., 329 U.S. 90, 103-104.

Whenever the statutory purpose to regulate commerce "permeates the entire congressional plan," the imposition of a tariff or duty

is a valid incident to the regulation of commerce. Board of Trust v. United States, 289 U.S. 48, 58-49 (1932). "Congress mav, and undoubtedly does, in its tariff legislation consider the conditions of foreign trade in all its aspects and effects. Its requir ments are not the less regulatory [under the commerce clause] because they are not prohibitory or retaliatory. They embody the congressional conception of the extent to which regulation should go. But if the Congress may thus exercise the power, and asserts, as it has asserted here, that it is exercising it [pursuant to the commerce clause of the Constitution], the judicial department may not attempt in its own conception of policy to distribute the duties thus fixed by allocating some of them to the exercise of the admitted power to regulate commerce and others to an independe exercise of the taxing power." Id. at 58.

Conversely, Congress in the exercise of its taxing power may as an incident thereof bring about a regulatorv effect. Sonzinsky v. United States, 300 U.S. 506 (1936).

To completelv understand the purpose and effect of the statut challenged in these proceedings, a few words concerning its historical background will be useful.

The Wheat Marketing Allocation Program is a part of the Agricultural Adjustment Act of 1938, as amended (7 U. S. C. §§ 128 1379a-1379j), and the Congressional findings and statutory provisi with respect to the Wheat Marketing Allocation Program are underscored by the Congressional findings in 1938 with respect to wheat

s follows: "Wheat * * * is produced throughout the United States y more than a million farmers, is sold on the country-wide market nd, as wheat or flour, flows almost entirely through instru-entalities of interstate and foreign commerce from producers to onsumers. Abnormally excessive and abnormally deficient supplies f wheat on the country-wide market acutely and directly affect, urden, and obstruct interstate and foreign commerce. Abnormally xcessive supplies * * * depress the price of wheat in interstate nd foreign commerce, and otherwise disrupt the orderly marketing f such commodity in such commerce. Abnormally deficient supplies esult in an inadequate flow of wheat and its products in interstate nd foreign commerce * * * and with excessive increases in the rices of wheat and its products in interstate and foreign commerce. . . . The conditions affecting the production and marketing of heat are such that, without Federal assistance, farmers, individ-ally or in cooperation, cannot effectively prevent the recurrence f such surpluses and shortages and the burdens on interstate and oreign commerce resulting therefrom, maintain normal supplies of heat, or provide for the orderly marketing thereof in interstate nd foreign commerce." 7 U. S. C. § 1331.

There are additional tokens of Congressional purpose within he statute and outside of it. As noted p. 2 infra, in 1962 ongress enacted further amendments to the Agricultural Act of 938 which stated, in part, "Wheat.... is one of the great export rops of American agriculture and its production for domestic

consumption and for export is necessary to the maintenance of a sound national economy and to the general welfare. ....It is necess in order to assist wheat producers in obtaining fair prices, to regulate the price of wheat for domestic food and for exports in the manner provided in this subtitle." 7 U. S. C. 1379a. (Emphas supplied.) Furthermore the Wheat Marketing Allocation Program - enacted by Congress with regard, *inter alia*, to our international obligations (78 Stat. at 181, 7 U. S. C. § 1379d(b)) - is to be interpreted so as to be consonant with the multilateral Internatio Wheat Agreement, 1962, the objectives of which are:

> "(a) To assure supplies of wheat and wheat-flour to importing countries and markets for wheat and wheat-flour to exporting countries at equitable and stable prices;
>
> "(b) To promote the expansion of the international trade in wheat and wheat-flour and to secure the freest possible flow of this trade in the interests of both exporting and importing countries, and thus contribute to the development of countries, the economies of which depend on commercial sales of wheat;
>
> "(c) To overcome the serious hardship caused to producers and consumers by burdensome surpluses and critical shortages of wheat;
>
> "(d) To encourage the use and consumption of wheat and wheat-flour generally, and in particular in developing countries, so as to improve health and nutrition in those countries and thus to assist in their development; and
>
> "(e) In general to further international cooperation in connexion with world wheat problems, recognizing the relationship of the trade in wheat to the economic stability of markets for other agricultural products." 13 *United States Treaties and Other International Agreements*, p. 1572.

The President, in submitting the International Wheat Agreement o the United States Senate, transmitted to the Senate the report f the Secretary of State regarding the International Wheat greement, and it is there stated:

> "The principal benefit of the agreement to the United States is the price range, internationally accepted as reasonable, notwithstanding the present imbalance of world supply and effective demand. It undergirds the national policy of withholding excess stocks from the export market, rather than dumping them with disastrous effects upon world and domestic prices. Operations under the agreement also provide a useful framework within which to conduct the U.S. export payment programs on wheat and flour which are necessitated by domestic price levels." Sen. Executive D., 87th Cong., 2d Sess., p. 4.

The question then, is whether the statute requiring the ırchase of export certificates was, indeed, a regulatory measure esigned to benefit commerce and to protect the domestic economy, r was it, in reality, a taxing statute in the guise of a regulation. or, as held in Wickard v. Filburn, supra "the stimulation of comerce is a use of the regulatory function [under the commerce lause of the Constitution] quite as definitely as prohibitions r restrictions thereon." 317 U.S. at 128.

The Wheat Allocation Program in non-technical language has een described by Mr. Godfrey. (R. 41-47). Reduced to its ssentials, the program provided:

a. For voluntary limitation of production, and adoption of specified conservation practices.

b. Price supports for those complying with the program, through CCC loans.

c. Subsidies through issuance of wheat certificates valued at 70 cents for wheat consumed for food in the United States and 25 cents per bushel of a certain portion of wheat to be exported.

d. Financing of the above subsidies through sale of certificates to processors and exporters - based on a rate of 70 cents per bushel of wheat used for food, and 25 cents per each bushel of wheat exported.

e. A payment to exporters of whatever sum is needed to make American wheat competitive in the world market.

The Wheat Allocation Program then had several apparent objectives:

a. To stabilize the farmer's income.

b. To prevent windfall profits to exporters, but at the same time to guarantee their ability to meet foreign competition on the world market.

c. To assist the stabilization of the world wheat prices.

d. To avoid burdening the American taxpayer with the costs of the program.

Such a program, with such objectives, certainly cannot be termed anything but regulatory. None of the features of a taxing statute is present. Taxes are levied to produce income to meet fixed expenses. A taxing program to be effective must produce income, and the amount of that income must be subject to fairly accurate computation. Here, the program may or may not have resulted in producing revenues. The exporters, although paying 25 cents per bushel, may have received refunds and subsidies totalling in excess of 25 cents. Rather than produce income the

rogram may have produced a deficit.[8/]

So much for the economics of the program. Now let us turn to udicial rulings bearing upon regulatory statutes comparable to hat involved here.

In Wickard v. Filburn, supra, the Agricultural Adjustment Act f 1938, which controlled the production of wheat, and provided or penalties on production of excess wheat, was attacked on the round that it violated the commerce clause and the due process lause of the Fifth Amendment. The contention was made that Congress as invading matters purely local in character.

"The wheat industry," the Supreme Court noted, "has been a roblem industry for some years." (P. 125.) "In the absence of egulation, the price of wheat in the United States would be much ffected by world conditions." (P. 126.) "Many countries, both nporting and exporting, have sought to modify the impact of the orld market conditions on their own economy. Importing countries ave taken measures to stimulate production and self-sufficiency. ne four large exporting countries * * * have all undertaken

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/ During the fiscal year ending June 30, 1965, the Commodity Credit orporation received from the wheat certificate operations (both omestic and export) net proceeds of $106,652,864. But this was ore than offset by export subsidy payments and the value of arketing certificates reflected in the price Commodity Credit orporation paid for wheat products. Hearings before Subcommittee f the House Committee on Appropriations on the Department of griculture Appropriations for 1967, 89th Cong., part 3, p. 295.

various programs for the relief of growers. Such measures have been designed, in part at least, to protect the domestic price received by producers." (PP. 125-126.)

The Court then upheld the Act as a valid exercise of the plenary power of Congress to regulate commerce. The Wheat Marketing Allocation Program in the case _sub judice_ is also authorized by certain provisions of the Agricultural Adjustment Act of 1938, as amended. To be sure, the provisions for the Whea Marketing Allocation Program had not been enacted by Congress at the time of the decision in _Wickard_ v. _Filburn_, _supra_. But th statutory measure in its totality both then and now is plainly a regulation of commerce.

Likewise, a monetary penalty imposed by Congress on the marketing of excess cotton under the Agricultural Adjustment Act of 1938, as amended, has been held not to violate Art. I, § 9, clause 5, of the Constitution even though the cotton was for exportation. _United States_ v. _West Texas Cottonoil Co._, 155 F. 2 463, 465-466, C.A. 5 (1946). The Court noted that the monetary penalty "has for its object not the prevention or burdening of exportation, but the prevention of raising for market, and market cotton in excess of the allotment." _Id._ at 465. To be sure, the imposition of the monetary penalty is a type of economic burden under the regulatory program, but there is no impingement on Art. § 9, clause 5, of the Constitution. _Id._ at 465-466.

In the case of *Pace* v. *Burgess*, 92 U.S. 372 (1875) and *Turpin* v. *Burgess*, 117 U.S. 504 (1886) a congressional enactment established an excise tax of 32 cents per pound on all manufactured tobacco, except smoking tobacco, which was taxed at the rate of 16 cents per pound. For tobacco to be exported a stamp costing 25 cents had to be affixed to each package. The price of the export stamp was later reduced to 10 cents. Some years later, Congress enacted a statute removing the "export tax" on tobacco.

The plaintiffs challenged the stamp as an export tax in violation of the Export Clause of the Constitution. The Court concluded that the monetary charge was not a tax or duty but a regulatory measure to "facilitate the disposal of tobacco intended for exportation" (92 U. S. at 374) and a "means devised to prevent fraud, and secure the faithful carrying out of the declared intent with regard to the tobacco so marked" (92 U. S. at 375). The Court said that the charge "may be an arbitrary one; but an arbitrary rule may be more convenient and less onerous than any other which can be adopted. * * * In the case under consideration, having due regard to that latitude of discretion which the legislature is entitled to exercise in the selection of the means for attaining a constitutional object, we cannot say that the charge imposed is excessive, or that it amounts to an infringement of the constitutional preovisions referred to." 92 U. S. at 375-376. Also see: *Rodgers* v. *United States*, *supra*; *Mulford* v. *Smith*, 307 U. S. 38 (1939); *Armour Packing Co.* v. *United States*, 209 U.S. 56 (1907), *Cornell* v. *Coyne*, 192 U.S. 418 (1903).

The appellant here appears to contend that the power to regulate foreign commerce has been whittled away by the Export Clause - that is that Congress cannot, in the exercise of its power under the commerce clause, take any regulatory action which as a concomitant, imposes a levy upon exports. In other words, as we understand appellant's position, insofar as <u>foreign</u> commerc is concerned the question is not whether the statute is regulator or for revenue purposes but whether the statute, regardless of statutory purpose, imposes a burden on exports. If it does it violates the Constitution.

The cases cited by appellants do not support this propositio

Four of the five cases relied on are specific revenue measur

In <u>Fairbanks</u> v. <u>United States</u>, 181 U. S. 283 (1900) a federa tax on bills of lading covering wheat exports under the War Reven Act of 1898 was held invalid by a five to four decision.

In <u>United States</u> v. <u>Hvoslef</u>, 237 U. S. 1 (1914) stamp taxes charter parties for carriage of cargo to foreign ports under the War Revenue Act of 1898 was declared in violation of the Export Clause.

In <u>Thames and Mersey Insurance Co</u>. v. <u>United States</u>, 237 U. 19 (1914) stamp taxes under the War Revenue Act of 1898 and cover insurance policies on exports was held invalid.

In <u>A. G. Spalding Co</u>. v. <u>United States</u>, 262 U. S. 66 (1922) tax on baseball equipment to be exported, under the War Revenue A of 1917 was ruled invalid.

The case of Brown v. Maryland, 12 Wheat. 419 (1827) involved a state statute requiring importers to take out a $50 license fee. The Court ruled that taxation of imports was the exclusive province of the Congress.

Thus the authorities relied on do not support the appellant's theory that the Export Clause has limited Congress in its exercise of the Commerce power.

Of far greater significance are the cases dealing with Article I, Section 10, Clause 2 of the Constitution which provides that: "No state, shall without the consent of the Congress, lay any Import or Duties on Imports or Exports, except what may be absolutely necessary for executing its inspection Laws.." The similarity in language between the two export clauses has been noted, and in Turpin v. Burgess, supra, the Court stated that the "constitutional prohibition against taxing exports is substantially the same when directed to the United States as when directed to a State." (117 U. S. at 506-507). It has also been held that the word "export" has the same meaning under the two clauses. Empressa Siderurgica v. Merced Co., 337 U. S. 154, 156, fn. 2 (1948). And it is well settled that a State may require a monetary payment as part of a regulatory program even though the charge or fee relates to imports or exports. In Cooley v. Board of Wardens of Port of Philadelphia, 12 How. 299, 310, 313 (1851) the court upheld the propriety of a State law requiring vessels which refused to take a pilot to pay one-half the regular amount payable for pilotage. It held that the

measure was designed to regulate navigation and was not in the nature of a tax in violation of the Constitutional prohibition. Also see: Clyde Mallory Lines v. Alabama, 296 U.S. 261, 263-268 (1935); Polar Co. v. Andrews, 375 U.S. 361, 371, 374, 381-383 (1963).

It is submitted that the wheat allocation program is in every sense a regulatory program, with its ultimate goal the stabilization of prices and income, and that whatever revenue may result is insignificant and incidental. The statute, then, is a valid exercise of the commerce clause, and constitutional.

III. <u>THE EXPORT CERTIFICATES DID NOT BURDEN EXPORTS.</u>

Appellant's chief reliance appears to be founded on the history of the Export Clause at the Constitutional Convention as reported by Farrand. An attempt to piece together at this late date the various social, political and economic motives which led to the rejection of certain proposed amendments, or to the location of the Export Clause outside both the Taxing and the Commerce Clauses does not lead to any conclusive results.[9/]

However, from the various commentaries it must be conceded that certain members of the Convention were concerned with the placement of burdens upon southern exports. And for the sake of argument, let us assume that the Constitution forbad the Congress to burden exports with taxes, duties or otherwise (and this is the most favorable interpretation appellant could hope for) could appellant establish here that the Wheat Allocation Program did, in fact, burden exports? We submit that quite the reverse is true. The object of the program, as stated in the statute, is to "make the United States wheat and

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9/ In <u>Pace</u> v. <u>Burgess</u>, <u>supra</u>, the plaintiff in error made the same argument advanced by the appellant in this case, to-wit, that since a proposal at the Convention to insert after the word "duty" the words "for the purpose of revenue" was rejected by a vote of eight states to three it was evident that the framers of the Constitution had rejected the idea that a tax or duty could be employed to regulate trade. (p. 372). The Supreme Court did not deem the argument of sufficient weight to justify any mention. For additional discussion of the Constitutional history, see 1 Story, Constitution of the United States (5th Edit., 1891) at pages 661-762, and 2 Story at pp. 2-44.

wheat flour generally competitive in the world market, avoid disruption of world market prices, and fulfill the international obligations of the United States." 78 Stat. at 181, 7 U.S.C. § 1379(b). And certainly the charge for an export certificate in this case did not prevent the exportation of the wheat or impose a burden upon the exporter. The net charge for the export certificate (face value less the refund) reflected the amount by which the world price exceeded the domestic price. There was, therefore, no charge for export certificates, except where world prices were high than domestic prices. In July 1964, for example, the average U. S. market price for #1 Hard Winter wheat f.o.b. Gulf was $1.72; the cost of such wheat to an exporter including the cost of certificate therefore, totaled $1.97; the export price at which U. S. wheat would be competitive in the international market was determined to be $1.87. Accordingly, the certificate refund for #1 Hard Winter wheat exported from the Gulf during July was $.10, i.e., $1.97 less $1.87. The charge of $.25 per bushel for export certificates, whil thus more than enough to cover the difference between domestic prices and world prices in some cases, is necessary in order that it will always be enough to cover the difference in any transaction regardless of a discount, or difference in qualities or grades involved, or the time of the year when the sale is made. By this flat charge-and-variable refund device, the exporter is able to compete on the international market without disruption of world market prices. He is also able to pass on to the buyer that part

f the cost of the certificates for which he had not obtained a efund from the Commodity Credit Corporation.

The exporter not only received a full refund of the cost of ertificates, in many instances, but was paid, in addition, a ubsidy in order to make his wheat competitive. Thus, in the case f #1 Dark Northern Spring wheat in April 1965, the U. S. market rice at Duluth including the cost of certificates was $1.98; the xport price necessary to make U. S. wheat competitive was $1.60. herefore, for shipments from Duluth in this month the exporter eceived a full refund of the $.25 certificate and in addition a ubsidy of $.13 ($1.98 less $1.60). (R. 48-49).

Rather than act as a deterrent to exports it seems evident hat the program encouraged exports since it removed much of the ncertainty with respect to world market prices. The exporter when ontracting to sell wheat to foreign customers had the advantage of nowing that regardless of daily fluctuations his costs would be ow enough to enable him to meet foreign competition. Under such onditions, what is the burden on exports? Appellees submit that here was none.

Congressman Purcell, Chairman of the Wheat Subcommittee of the ouse Agriculture Committee, confirmed the value of the certificate rogram to the exporter.

> Recall the national average loan rate would have been $1.26 instead of the $1.30 a bushel provided under the 1964 voluntary certificate plan. The 1964 wheat crop would have exceeded the 1,290 million bushels now in prospect. Additional production coupled with a lower

market price support level undoubtedly would have resulted in a lower season average price than will obtain.

Wheat from the United States would have been available to importing countries at a market price reflecting this lower loan rate and excess supply position. Other wheat exporting countries would have been forced to lower the price of wheat to meet this competition. In view of current world wheat prospects for the 1964-65 marketing year, the lower world price probably would not have resulted in an increase in sales. The current wheat program, authorizing export certificates, has prevented this potential loss to all exporting countries from becoming a reality.

Therefore, it seems clear that the 1964 wheat program contributes to a higher world price and because of this, returns from exports will be higher than they would have been in the absence of legislation.

Export certificates, authorized by the Agricultural Act of 1964, simultaneously help improve farm income and insure continued world wheat price stability at a higher level than would be the case without the act. The difference between the cost of wheat to the exporter - including the export certificates - and the price necessary to keep U. S. wheat competitive in world markets is refunded to the exporter. A higher world price simply means a lower subsidy payment. 110 Cong. Rec. 23807.

IV. THE PRESUMPTION OF THE CONSTITUTIONALITY OF THE ACT HAS NOT BEEN OVERCOME.

"The presumption is in favor of every legislative act, and the whole burden of proof lies on him who denies the constitutionality
Brown v. Maryland, 12 Wheat. (25 U.S.) 419, 436 (1827). As Chief Justice Marshall also stated in McCulloch v. Maryland, 4 Wheat. (1 U.S. 316, 420 (1819):

We admit, as all must admit, that the powers of the government are limited, and that its limits are

> not to be transcended. But we think the sound construction of the constitution must allow to the national legislature that discretion, with respect to the means by which the powers it confers are to be carried into execution, which will enable that body to perform the high duties assigned to it, in the manner most beneficial to the people. Let the end be legitimate, let it be within the scope of the constitution, and all means which are appropriate, which are plainly adapted to that end, which are not prohibited, but consist with the letter and spirit of the constitution, are constitutional.

While the literal language used by the framers of the Constitu- ion cannot be disregarded, of greater significance is the evolving onstitutional philosophy. As also stated by Chief Justice Marshall t pages 413-414:

> This provision is made in a constitution, intended to endure for ages to come, and consequently, to be adapted to the various crises of human affairs. To have prescribed the means by which government should, in all future time, execute its powers, would have been to change, entirely, the character of the instrument, and give it the properties of a legal code. It would have been an unwise attempt to provide, by immutable rules, for exigencies which, if foreseen at all, must have been seen dimly, and which can be best provided for as they occur. To have declared, that the best means shall not be used, but those alone, without which the power given would be nugatory, would have been to deprive the legislature of the capacity to avail itself of experience, to exercise its reason, and to accommodate its legislation to circumstances.
>
> If we apply this principle of construction to any of the powers of the government, we shall find it so pernicious in its operation that we shall be compelled to discard it.

In this connection, it should be remembered that the men rafting the Constitution were determined to write a document which ould be flexible enough to accommodate the changing times and

circumstances. Today the times and circumstances are different. We are not concerned with real or fancied northern oppression of southern agriculture. We are concerned with the need for controlled production. We are concerned with the need for a stable world price for one of our major exports. We are concerned with the necessity of maintaining and stabilizing farm income. The Wheat Allocation Program was intended to resolve, to some extent at least, these problems, and the statute in question should not be declared unconstitutional in the absence of compelli proof of its violation of a constitutional mandate. In the langua of Justice Harlan in the case of Northern Securities Co. v. United States, supra (193 U.S. at 350): "...no higher duty rests upon thi court than to enforce, by its decrees, the will of the legislative department of the Government, as expressed in a statute, unless su statute be plainly and unmistakably in violation of the Constituti

Surely, the Wheat Allocation Program, and its requirement of marketing certificates, was not "plainly and unmistakably in viola of the Constitution."

CONCLUSION

The export certificates were neither a tax nor a duty in the constitutional sense, but were part of a regulatory scheme designe to enable the United States to honor its international commitment, to help stabilize world wheat prices, to assure American exporters a competitive position in the world market, and to assist in the stabilization of farm income. Rather than place a burden on

porters the plan as a whole was an obvious benefit to exporters.

e judgment of the district court should be affirmed.

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PTEMBER 1966

CERTIFICATE

I certify that, in connection with the preparation of this ief, I have examined Rules 18 and 19 of the United States Court Appeals for the Ninth Circuit, and that, in my opinion, the regoing brief is in full compliance with those rules.

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United States Court of Appeals

FOR THE NINTH CIRCUIT

SHIRLEY MOON,
Appellant,
vs.
ORVILLE FREEMAN, as Secretary of Agriculture, and COMMODITY CREDIT CORPORATION,
Appellees.

No. 21008

Appeal from a judgment of the United States District Court for the Eastern District of Washington, Northern Division

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HONORABLE CHARLES L. POWELL, *Judge*

APPELLANT'S REPLY

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AND
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United States Court of Appeals

FOR THE NINTH CIRCUIT

SHIRLEY MOON,
Appellant,
vs.
ORVILLE FREEMAN, as Secretary of Agriculture, and COMMODITY CREDIT CORPORATION,
Appellees.

No. 21008

Appeal from a judgment of the United States District Court for the Eastern District of Washington, Northern Division

---

HONORABLE CHARLES L. POWELL, *Judge*

APPELLANT'S REPLY

RESTATEMENT OF THE CASE

The facts are as outlined in Appellant's Opening Brief and Appellees' Counterstatement of the case, excepting that Appellees' Counterstatement of the case is misleading in the following particulars:

(1) The requirement that exporters purchase marketing certificates was not established for the purpose of financing payments to producers as stated by Appellees (page 4). There is no evidence to this effect; there is no regulation to this effect; and, the statute does not so provide. There is no relationship between the export certificates purchased by exporters and the payments made to producers. The amount of wheat exported was .523% of *actual* production, whereas certificates were payable to only *complying producers* on .45% of their *average* production (R. 11 & 12).

(2) The effect of the export marketing certificate is not to increase producer prices. The effect is to deprive the producer of the benefit of World prices by placing a Twenty-five (.25c) cent per bushel tariff, tax or duty on each bushel exported thereby reducing the availability of World price.

(3) Only after the export certificate had served the purpose of making United States wheat non-competitive is a refund in any amount provided to the exporter. Contrary to Appellees' contention at page 4 of their Brief, there was nothing tentative about the exporters' payment of Twenty-five (25c) cents per bushel. The payment was exact. The refund, if any, was tentative.

OUTLINE OF ARGUMENT

I. Appellees' arguments are answered in the format as set forth by them. In summary the answers are framed on the following basis:

(a) Appellees' Argument I and II assume the lack of any distinction between the terms "tax" and "duty," and, also assumes that Article I, Section 9, Clause 5 was not intended as a restriction on the exercise of the commerce powers. They, thereafter, fail to distinguish between the constitutional grants and restrictions of powers relating to three separate items: interstate commerce, commerce in the form of imports, and commerce in the form of exports. The power over interstate commerce and imports cannot be equated with the power over exports in view of the constitutional restrictions relating to latter.

(b) Appellees' Argument No. III and IV casts aside all Constitutional History in favor of an "evolving constitutional philosophy." The evolving constitutional philosophy, while properly interpreting grants of power in a manner to give full efficacy to the power in view changing needs, does not permit an interpretation resulting in a disregard of constitutional restrictions.

II. Appellant's Argument, restated, is:

(1) The term "tax or duty" as used in Article I, Section 9, Clause 5 contemplates a prohibition against the imposition of any economic burden on exports, or the process of exporting, whether the enactment is designed as a revenue raising or as a regulatory measure.

(2) Article I, Section 9, Clause 5, is not only a restriction on the taxing authority of Congress as granted in Article I, Section 8, Clause 1, but also

restricts the means available for regulating Commerce with foreign nations granted in Article I, Section 8, Clause 3.

REPLY TO APPELLEES' ARGUMENT I

Appellees' argument assumes that the words "tax or duty" as used in Article I, Section 9, Clause 5 are synonymous and connote only the raising of revenue for the general support of government. Appellees, by virtue of this assumption, arrive at the conclusion that the export limitation has no effect on the commerce regulatory powers.

Appellees' basic assumption is incorrect. There is no question but that the term tax, as used in Article I, Section 8, Clause 1, is generally defined as meaning a system for raising revenue for the general support of government. This is the basis for the holdings in each of the cases cited by Appellees. None of those cases, however, undertake to analyze and define the term "tax or duty" and specifically each word independently, as used in the Clause in question.

United States v. LaFrance, 282 U.S. 568 (1930), *Lipke v. Lederer,* 259 U.S. 557 (1921), and *United States v. Butler,* 332 U.S. 371 (1947) all fall in the general category of *defining the powers* of Article I, Section 8, Clause 1 and they relate specifically to defining the word "tax." None of the cases relate to the word "duty"; and, none of the cases are involved with the *restriction on power* in Article I, Section 9, Clause 5. They form no authority for interpreting that Section and Clause.

The *Head Money Cases* 112 U.S. 580 (1884) is not consistent with Appellees' position. The case involved a monetary fee imposed on imports, i.e. the business of bringing passengers from foreign countries. The Court was concerned with interpreting *two grants of power* (Article I, Section 8, Clause 1 and Article I, Section 8, Clause 3). It was argued that the "tax" was unconstitutional as not being for the common defense and general welfare. The Court sustained the matter on the basis of the commerce power. *In doing so the Court spoke of the tax—so far as it could be called a tax—as an "excise duty" permissible in regulating imports under the commerce clause.* It must be remembered that the limitations of Article I, Section 9, Clause 5, relate only to exports and that there is no similar restriction regarding imports. The case is significant in recognizing a distinction between the terms "tax" and "duty."

Appellees' argument (p. 9 & 10), that the export charges were intended to defray costs of export payments made to the producers is not sustained by the Act or the evidence.

Morrison Milling Co. et al v. Freeman, No. 19794 and *National Biscuit Co., et al, v. United States,* No. 19795, United States Court of Appeals, District of Columbia, involved domestic processors and does not purport to discuss the limitations regarding exports.

REPLY TO ARGUMENT II

Congress has the power, in the course of regulating interstate commerce, to impose economic burdens and

regulate prices. Interstate commerce, however, is not subject to the restrictions of Article I, Section 9, Clause 5 and, hence the nature of the authority as to each must be distinguished. Similarly, imports are not subject to the same restriction and a distinction must be recognized between the power over imports as opposed to exports. Appellees attempt to apply this same authority to foreign commerce, in the form of exports, does not find foundation in the authorities cited.

Rodgers v. United States, 332 U.S. 371, 374 (1947), *Wickard v. Filburn,* 317 U.S. 111 (1942), *United States v. Strangland* 242 Fed (2d) 843 CA 7 (1947) and *United States v. Rock Royal Corp.* 307 U.S. 533 (1938) all dealt with powers over interstate commerce. The *Head Money Case,* supra, and *Board of Trustees v. United States,* 289 U.S. 48 (1932) involved the issue of imports rather than exports.

Board of Trustees v. United States, supra, does make one substantive contribution to this case. The case involved the issue of whether a "duty" on imports was a "tax" and as such subject to the constitutional limitation that Congress may not lay a tax so as to impose a direct burden on an instrumentality of the State in the performance of a governmental function. The Court held that since the measure was intended for regulation rather than revenue, and raised only incidental revenue, the impost involved was an exercise of Congress' power to regulate commerce and not of the taxing powers. It discussed the impost on imports and spoke of it as a duty in view of its regula-

tory characteristics and *spoke of "duties" as a common means of exercising the power to regulate commerce.* The case supports the proposition that both revenue raising measures, and regulatory measures dependent on placing economic burdens on exports as an incident of regulation, are forbidden since both a "tax" and "duty" are forbidden by Article I, Section 9, Clause 5. If the word "duty" signifies a means for regulation of commerce, foreign commerce, then its use in the clause in question can only be construed to mean a restriction on the original grant of power to regulate foreign commerce.

United States v. West Texas Cottonoil Co. 155 F (2d) 463 C.A. 5 (1946) while holding that monetary penalty may be utilized to control production does not involve the imposition of a charge upon the act, or process of exporting or goods exported. The Court stated, furthermore:

> "Besides the authorities make it quite plain that the invoked Constitutional provision (Art. I, Sec. 9, Cl. 5) does not apply to a situation on the manufacture or handling of products. It applies only where it is laid specifically or exclusively on exports or matters directly connected with exports."

In the present case the economic burden is placed specifically and exclusively on exports.

Neither *Pace v. Burgess,* 92 U.S. 372 (1875) nor *Turpin v. Burgess,* 117 U.S. 504 (1886) cited by Appellees is in point. In each case the nominal charge involved had no relationship to exports other than to identify

the goods to be exported and to exclude them from a direct tax imposed upon domestically consumed products. The Court definitely pointed out:

> "The stamp was intended to no other purpose than to separate and identify the tobacco which The manufacturer desired to export . . . *It bore no proportion whatever to the quantity or value of the package to which it was affixed. These were unlimited except by the discretion of the exporter, or the convenience of handling." Pace v. Burgess,* supra. (Emphasis added)

In this case the charge fixed is a definite charge for each unit exported, and, is a condition of export.

Mulford v. Smith, 307 U.S. 38 (1939) involved a penalty on marketing of excess tobacco. It did not involve Article I, Section 9, Clause 5.

Armour Packing v. United States 209 U.S. 56 (1907) involved the regulation of freight rates on railroads in interstate commerce. The effect on exports was held to be too remote (i.e. not on the process of exports) to constitute a tax or duty.

Cornell v. Coyne, 192 U.S. 418 (1903) involved a general tax on all cheeses produced. No impost on the act of export was involved. The Court held that the prior ordinary burdens of taxes which rest on all similar property was not prohibited merely because some of that property was subsequently placed in export.

Appellees incorrectly set forth the import of *Cooley v. Board of Warden* (p. 25) 12 How. 299 (1851). The case held that pilotage fees, at the time the Constitution was adopted, were considered separate and dis-

tinct from taxes, duties and imposts and, therefore, were not within the definition of those terms as used in Article I, Section 10, Clauses 2 and 3.

Appellees' description of the Wheat Marketing Allocation Program, (pages 16 to 20 Appellees' Brief) is inaccurate and misleading in several important particulars.

(1) The Secretary of Agriculture had it wholly within his power to cause compliance with the International Wheat Agreement (13 *United States Treaties and Other International Agreements,* p. 1572) without the export marketing certificate and also had the power to stabilize farmers income in view of the fact that the original support price for wheat was to be established by the Secretary (Godfrey's Affidavit R. 42 para. 7); and,

(2) No where in the evidence (Godfrey's Affidavit R. 40-47), or in the Act, is there any authority for the statement that financing of the subsidies was to be through sales of certificates to processors and exporters.

Appellees' efforts to compare the restrictions on the powers of the States as set forth in Article I, Section 10, Clause 2 and the limitation of the power of Congress in Article I, Section 9, Clause 5 as to their power to lay "duties" is not accurate. The limitation on the powers of the States includes the express exception.

> ". . . except what may be absolutely necessary for executing its inspection laws."

The language, thus, permits regulation by the States on the basis of duties imposed to facilitate inspections. By creating this express exception to the term "duty" the Constitution tends to define the term itself as being a regulatory device on imports or exports. The express exception certainly implies that at the time the Constitution was framed the elimination of the power to impose a "duty" eliminates all power to regulate commerce—even to the extent of inspection. By providing that funds derived from duties in inspection laws should become a part of the general treasury the Constitution further implies that incidental revenue may be derived from duties, even though revenue is not their primary goal.

REPLY TO ARGUMENT NO. III

Appellees choose to ignore the Constitutional History. The entire argument proposed by Appellees begs the basic question. It is undisputed that Appellant exporter was charged the net sum of One Hundred Sixty-eight and 52/100ths ($168.52) Dollars to participate in the export market on a limited scale. His gross charge was Four Hundred Eleven and 93/100ths ($411.93) Dollars. His net proceeds were One Hundred Sixty-eight and 52/100ths ($168.52) Dollars less than they would have been had the Governmental burden not been imposed. To argue that this is not an economic burden seems totally inadequate.

The mere fact that the program finds it necessary to subsidize the exporter, in the form of refunding to him part of the export charges, is an unquestionable and irrefutable indication that the initial exaction

has been an economic burden on the process of exports. The admitted reason for any refund is that the initial exaction has placed the exporter in a position where he cannot compete on the World market. The "tariff" has priced him out of World competition.

Economic theory is argued in total reverse, that is, that World prices are established by domestic prices in the United States and, in effect that domestic prices (as controlled by the Secretary) are in no manner affected by World prices. In addition, it is strange to see Appellees argue in one breath that the payments made to complying producers are financed through the export charges, (which can only mean that they were profitable) and, in the second breath that there is no economic burden on the exporter or the process of exports because the CCC subsidized him in part, in full, or in excess of the price paid for certificates. The two arguments seem incompatible.

The fact that exporters pass on to the buyer the cost of the certificate involved does not eliminate the existence of an objectionable "tax or duty" of necessity this would occur in every type of "tax or duty." This issue was commented on by the Court in *Thames & Mercey Insurance Company Ltd. v. United States*, 237 U.S. 19 (1914) which involved a stamp tax on policies of insurance; and in a case involving taxation by the State of imports in *Brown v. Maryland* 7 U.S. 262 (1837). The Court held that an impost violated the mandate of the Constitution in effect because the impost of necessity raised the price of the article either to the consumer or the exporter or importer. As such the impost was an objectionable duty.

REPLY TO ARGUMENT IV

Every enactment of the Congress is presumed constitutional. There is also an evolving Constitutional philosophy. These two propositions are set forth in clarity by *Brown v. Maryland* 12 Wheat (25 U.S.) 419 (1827) and *McCulloch v. Maryland* 4 Wheat (17 U.S.) 316 (1819).

The evolving Constitutional philosophy has never permitted, or required, a total disregard of the express restrictions imposed on the central government, or Congress specifically. Grants of power in the Constitution, under the evolving constitutional philosophy, must be construed to give full efficacy to those powers. Similarly restrictions on grants of power must be given a full effect consistent with the spirit of the restrictions.

Chief Justice Marshall, who authored the opinions in *Brown v. Maryland,* supra, and *McCulloch v. Maryland,* supra, certainly did not intend the broad application espoused by Appellees, that the Constitution be construed in the "light of the times" to the extent that the spirit of its restrictions should be destroyed. In *Marbury v. Madison,* 1 Crench 137 (1803) he discussed the limitations on Federal Power

> "The government of the United States is of the latter description (limited powers). The powers of the legislature are defined and limited; and that those limits may not be mistaken or forgotten, the constitution is written. To what purpose are powers limited, and to what purpose is that limitation committed to writing, if these limits may, at any time, be passed by those intended to be restrained? The distinction between a govern-

> ment with limited and unlimited powers is abolished, if those limits do not confine the persons on whom they are imposed, and if acts prohibited and acts allowed, are of equal obligation. It is a proposition too plain to be contested, that the Constitution controls any legislative act repugnant to it; or, that the legislature may alter the Constitution by an ordinary act."
>
> "Between these alternatives there is no middle ground. The Constitution is either a superior paramount law, unchangeable by ordinary means, or it is on a level with ordinary legislative acts, and, like other acts, is alterable when the legislature shall please to alter it."

In *Fairbanks v. United States* 181 U.S. 283 (1900) the Court, in discussing Article I, Section 9, Clause 5 restated the theory of interpretation of constitutional restriction

> *"It is a restriction* on the power of Congress; and as, in accordance with the rules heretofore noticed, the grants or powers should be so construed as to give full efficacy to those powers and enable Congress to use such means as it deems necessary to carry them into effect, so in like manner a *restriction should be enforced in accordance with its letter and spirit, and no legislation can be tolerated which, although it may not conflict with the letter, destroys the spirit and purpose of the* restriction imposed. (Emphasis added)

The theory of an evolving Constitution can only mean that, while a grant of power must be given an interpretation permitting its full exercise in view of the needs of the nation, nevertheless that interpretation may not be inconsistent with, or eliminate, restrictions imposed on the exercise of Congressional power. To do otherwise is to allow an entirely un-

bridled legislative branch which alone, day by day, on the basis of immediate national policy modifies and alters Constitutional limits.

As Chief Justice Marshall stated, there is no middle ground. There is no room for an evolving constitutional philosophy which results in the total disregard of restrictions on the exercise of power, and, the evolving constitutional philosophy has not previously been requested to cover such a broad spectrum of Congressional authority.

RESTATEMENT OF APPELLANT'S ARGUMENT

(1) The term "tax or duty" as used in Article I, Section 9, Clause 5 is not limited to the connotation of revenue raising measures. Rather, the term is designed to prohibit the imposition of any economic burden on exports, or the process of exports; and thus to serve as a restriction on both the general taxing powers of the central government, and the commerce powers.

The Constitutional History of the clause supports this interpretation. The debate in the Constitutional Convention revolved around the need to permit duties or taxes on exports as a means of regulating trade. The attempted amendments designed to permit the regulation of trade were all defeated. *Farrand,* The Records of the Federal Convention, Vol. II pps. 359-365; *Madison,* "Journal of the Constitutional Convention" Vol. II, p. 574.

(2) The words "tax" and "duty" are separate and istinct words. Each must be given consideration.

> "In expounding the constitution every word must have its due force, and appropriate meaning; for it is evident from the whole instrument that no word was unnecessarily used, or needlessly added—Every word appears to have been weighed with utmost deliberation, and its full force and effect fully understood."
>
> Chief Justice Tanney in *Holmes v. Jennison,* 14 Pet. 540. See also *Wright v. United States,* 302 U.S. 583.

The term "duties" has been generally considered s a system for commercial regulation—specifically ıe regulation of imports and exports. *University of llinois v. United States,* 289 U.S. 48 (1933); *Pollock . Farms Loan & Trust Co.,* 158 U.S. 601 (1895); *'homas v. United States,* 192 U.S. 370 (1903); *Story,* 'ommentaries on the Constitution, Vol. II, sec. 1088. The use of the word "duties" in conjunction with he word taxes, results in prohibiting the regulation f commerce through the imposition of an economic urden.

(3) The restrictions of Article I, Section 9, Clause , have consistently been authoritatively recognized s restricting both the general taxing powers and the ommerce powers. *Storey,* Commentaries on the Contitution of the United States, Vol. I, p. 712 (1873); *Burdick,* The Law of the American Constitution, p. 94; *Willoughby* on the Constitution, Vol. II (2d ed), . 694; *Gavit,* The Commerce Clause of the United States Constitution, p. 202; *Weaver,* Constitutional Law and its Administration, p. 286.

(4) The Courts have recognized that the commerc clause is subject of limitation (*Adair v. United States* 208 U.S. 161, (1907); *Gibbons v. Ogden,* 22 U.S. (1824)) and that Article I, Section 9, Clause 5 is on of those limitations.

(5) The Courts have uniformly rejected any di rect imposition of economic burdens on exports an directly insisted on free access to foreign markets.

> ". . . the question of power is not to be deter mined by the amount of the burden attempted t be cast. The constitutional language is, 'no ta or duty.' "

> ". . . *the purpose of the restriction is that ex portation*** all exportation—shall be free fron national burden.* This intent, though obvious fron the language of the clause itself, is reinforced b the fact that in the Constitutional convention Mr Clymer moved to insert after the word 'duty' th words 'for the purpose of revenue,' but the motio was voted down. *So it is clear that the framers o the Constitution intended, not merely that ex ports should not be made a source of revenue t the national government, but that the nationa government should put nothing in the way of bur den upon such exports. If all exports must be fre from national tax or duty, such freedom require not simply an omission of a tax on the articles e ported, but also a freedom from any tax which d rectly burdens the exportation; . . .*" (Emphas added) *Fairbanks v. United States,* 181 U.S. 28 (1900)

See also *Thames & Mersey Marine Insurance Co. ,td. v. United States,* 237 U.S. 19 (1914); *United 'tates v. Hvoslef,* 237 U.S. 1 (1916); and *Brown v. laryland,* 7 U.S. 262 (1837).

Exports and the process of export are to be free rom economic burden. A clear economic burden is mposed under the Act. The burden is a direct im- ost occurring as a condition of export. As such it is learly on the process of exports, if not on the article tself. The Act is unconstitutional in imposing this urden.

CONCLUSION

The following sections of the Agricultural Adjust- nent Act of 1964 should be declared unconstitutional, o-wit; 7 U.S.C. 1379c (a) (As amended Apr. 11, 1964, Pub. L. 88-297, Title II Sec. 202 (12-14), 78 Stat. 180, 181); 7 U.S.C. 1379c (C) (As amended Apr. 11, 1964, Pub. L. 88-297, Title II, Sec. 202 (12) - (14), 78 Stat. 180, 181); 7 U.S.C. 1379d (b) (As amended Apr. 11, 1964, Pub. L. 88-297, Title II, Sec. 202 (15) - (17); 78 Stat. 181, 182), insofar as said sections re- quire the purchase of export marketing certificates as a condition of exporting wheat.

The Order granting Appellees' Motion for Summary Judgment (Tr. 81) should be reversed and an Order should be entered granting Appellant's Motion for Summary Judgment and granting Appellant Judgment in the sum of $168.52 and costs.

DATED, Colfax, Washington
October 7, 1966

Respectfully submitted,

WESLEY A. NUXOLL
Attorney for Appellant

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

WESLEY A. NUXOLL
Attorney for Appellant

No. 21015

United States
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for the Ninth Circuit

MARYLAND CASUALTY COMPANY,
a Maryland Corporation,

Appellant,

v.

CLEAN-RITE MAINTENANCE COMPANY,
an Oregon Corporation,

Appellee.

APPELLANT'S OPENING BRIEF

Appeal from the United States District Court
for the District of Oregon
HONORABLE BRUCE R. THOMPSON, District Judge

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HONORABLE BRUCE R. THOMPSON, District Judge

JURISDICTIONAL STATEMENT

This is an appeal from a directed verdict and judgment thereon in favor of the appellee rendered in the United States District Court for the District of Oregon. The jurisdiction of the District Court rests upon *diversity* pursuant to 28 U.S.C. § 1332, and the jurisdiction of this court exists by virtue of 28 U.S.C. § 1291.

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STATEMENT OF THE CASE

Maryland Casualty Company, plaintiff-appellant, (hereinafter referred to as "Maryland"), was the public liability insurance carrier for the estate of Marie Caraplis, deceased, which estate was and still is the owner and operator of an office building in Portland, Oregon, commonly known as the Postal Building. Charlotte Ann Relos and Georgia Mae Caraplis were coexecutrices of the estate of Marie A. Caraplis, deceased, and Charlotte Ann Relos (hereinafter referred to as "Mrs. Relos") was the manager of the Postal Building in her fiduciary capacity.

Defendant-appellee, Clean-Rite Maintenance Company, was an Oregon corporation engaged in the business of maintenance work. Mr. V. J. Hill (hereinafter known as "Mr. Hill") was the president of Clean-Rite Maintenance Co., (hereinafter referred to as "Clean-Rite"). Lee A. Ramsey (hereinafter known as "Ramsey"), was an employee of Clean-Rite on June 12, 1963.

Prior to June 12, 1963, Mrs. Relos was managing the Postal building as coexecutrix of the aforementioned estate. She entered into an oral agreement with Clean-Rite, through Mr. Hill, whereby Clean-Rite agreed to clean the windows of the Postal building. The extent and nature of the agreement forms part of the issue in the within appeal.

Ramsey, while employed by Clean-Rite, on June 12, 1963, while engaged in washing the Postal Building windows, fell from the 4th to the 2nd floor (the roof of an

adjoining building), and sustained severe personal injuries. Ramsey thereafter brought an action against the estate in Multnomah county, seeking damages for personal injuries suffered in his fall. The Postal Building tendered the defense of the Ramsey action to Clean-Rite. When Clean-Rite refused the tender, Maryland, as the public liability insurance carrier of the estate, undertook the defense and subsequently settled the Ramsey action for $22,500.

The within action is one for breach of contract, whereby Maryland, as subrogee of the owners and operators of their insured, the Postal Building, contend that Clean-Rite breached its contract to procure insurance to protect the owners and operators of the Postal Building from losses such as that sustained in the Ramsey case. Basically, Maryland's evidence showed that the agreement entered into between Clean-Rite and Mrs. Relos on behalf of the Postal Building included an agreement that Clean-Rite would procure insurance which would protect the Postal Building of and from any and all claims of any kind and nature arising out of the window washing operations of Clean-Rite.

At the trial, Clean-Rite contended: (1) that Maryland was not entitled to subrogation; (2) that there was no legally enforceable contract to procure insurance for the Postal Building.

Charlotte Ann Relos was the manager of the Postal Building (Tr. 31). The Postal Building had public liability insurance with Maryland at the time of the accident to Ramsey (Tr. 31).

Mrs. Relos first met Mr. Hill about two years prior to the accident when she was looking for someone to do the window washing on the building. She heard of Mr. Hill from a mutual friend and looked up his ad in the telephone book (Tr. 31).

At the time of the negotiations between Mrs. Relos and Mr. Hill regarding the contract, Associated Building Maintenance Company was cleaning the Postal Building windows (Tr. 33). At the initial conference, Mrs. Relos testified that they spoke of insurance as follows:

> "A. Well, I called him and he came down to the office and we were discussing doing the window washing at the building, and I told him that—I asked him what type of coverage he carried, because we wanted complete coverage on everything.
>
> And he went on to tell me, particularly I do remember the rest of the conversation that he carried extra insurance with the Zurich Company, and that is why he had to charge a bit more for—on the regular rate. Most of the window washers have about the same rate for the size of the building. I think they do it on account of the windows. At any rate, his fee was more, and I asked him why, and he said because he carried such extra heavy insurance to cover us in any circumstances which might arise." (Tr. 32-33)

Several other conversations were held where the same representation was made and insurance thoroughly discussed by the parties (Tr. 33). Mrs. Relos hired Mr. Hill because, although the charge was more, "I figured we had better protection" (Tr. 34).

When the contract between the Postal Building and Associated Building Maintenance Company expired, in the middle of June, 1963, Mrs. Relos and Mr. Hill spoke again and Mrs. Relos testified:

> "Yes, and our contract had expired with the previous firm, and I told him that this would be a contract basis, and he said, 'Fine.'" (Tr. 34)

The contract was to be of 12 months' duration (Tr. 34-35).

Mrs. Relos first contacted Mr. Hill by examining the yellow section of the telephone book (Pl. Ex. 7) page 748 (Tr. 35-36). She testified:

> "Q. What is that you are looking at?
>
> A. Well, it is the large ad in the advertising, Clean-Rite Maintenance, and goes on to say what they do, and fully insured for your protection.
>
> Q. Did you read that?
>
> A. Yes, I did. And, as I told you, I am particularly interested in ads in this yellow section, because I used to write them when I worked for the telephone company." (Tr. 36-37)

The contract price with Clean-Rite was $60, whereas the consideration for the previous contract with Associated Building Maintenance Company was $47.50 (Tr. 37). The windows were to be cleaned every other month (Tr. 37).

Under cross-examination, Mrs. Relos testified:

> "A. He said that we would be completely covered if anything arose that was wrong that would hurt us; anything wrong he would have the complete insurance coverage, and that is all I was interested in.

Q. So far as his operations were concerned, you were fully protected?

A. Yes.

Q. That is as far as the conversation went?

A. No. We went into it.

Q. What else did you go into?

A. He told me that he carried a type of bond. Now—a type of bond, and he carried this Zurich, with the Zurich Company, and he told me that it just covered extra insurance.

And I asked him, 'Why do you charge more than—' most window washing companies charge about the same. And he said because of the extra coverage he carried, and that is why he had to charge more, but in turn the people that had his services were covered more." (Tr. 40-41)

Defendant's sealed Exhibit No. 22 was a letter dated August 29, 1963, addressed to Hill by Mrs. Relos, which contained the following:

"Dear Sir:

When we discussed your rates for the window washing in the Postal Building, you explained to me that they were higher than I expected because you carried such extensive insurance to cover any exigency that might arise.

As you know Mr. Lee Ramsey has engaged an attorney to pursue a claim against the Postal Building for injuries received in the accident of 6/12/63.

It occurs to me now in view of your earlier comments about insurance that the Postal Building might be covered for this claim under your insurance policies.

I would appreciate it if you would advise me as soon as possible on this point." (Tr. 43)

The most recent telephone directory yellow pages revealed a complete change in language employed by Clean-Rite:

> "If it is glass—we clean it. All employees bonded and insured. For information call Clean-Rite Building Maintenance Company, Inc." (Tr. 61)

Mr. Hill admitted there were prior conversations before the contract was entered about what he termed "bond" (Tr. 62-63). He had earlier testified that there were no conversations about insurance prior to the entering of the contract (Tr. 58).

Following presentation of the evidence and some legal argument, the court directed a verdict in favor of the defendant-appellee Clean-Rite Maintenance Company (Tr. 90-91). The judgment on record herein indicates the court's summation of its reasons for so ruling.

It is appellant's position that the court's ruling was clearly erroneous and that there was sufficient evidence to take the case to the jury.

SPECIFICATIONS OF ERRORS

1. The District Court erred in directing a verdict in favor of the defendant-appellee and against the plaintiff-appellant, ruling that plaintiff-appellant failed to make a jury question.

2. The District Court erred in holding that the contract between the appellant's subrogor and the appellee was too vague and indefinite to be enforceable.

3. The District Court erred in finding that the agreement between the plaintiff-appellant's subrogor and the defendant-appellee was one of insurance, or one to indemnify, instead of an agreement to procure insurance, and in misapplying the law of the former to the latter.

SUMMARY OF ARGUMENT

The District Court erred in failing to submit the within controversy to the jury. The directed verdict in favor of the defendant was premised upon a misconception of plaintiff's theory of the case: a breach of *contract to procure* insurance in contradistinction to a contract to insure.

ARGUMENT

1. Appellant introduced substantial evidence of a contract to procure insurance on the part of appellee.

This appeal is occasioned by an unfortunate misconception of the appellant's theory of recovery by the District Court (apparently aided by the misunderstanding of appellee). The judgment order reflects this error (p. 2):

> "The court, after having heard argument of counsel and having itself examined into the law relating to the matter, concluded therefrom that defendant's motion for a directed verdict was well taken and should be granted for the reason that plaintiff's evidence had failed to make out sufficient evidence of the terms of an oral contract of insurance to protect the Postal Building or to indemnify the Postal Building or the plaintiff as contended

for by the plaintiff in its complaint and pretrial order."

The complaint passes from the case under the pretrial order. There, plaintiff-appellant contended, III (1):

> "That as a part of the agreement entered into between the Defendant and the estate of Marie A. Caraplis whereby the Defendant agreed to clean the windows of the Postal Building, it was further agreed that the Defendant would *procure insurance* which would protect the estate of Marie A. Caraplis of and from any and all claims of any kind and nature." (emphasis supplied)

The issues of fact set forth in the pretrial order included, *inter alia,* V(1), (2):

> "(1) Did Defendant agree to *procure insurance* for the benefit of the estate of Marie A. Caraplis which would save harmless the estate of Marie A. Caraplis of and from any and all claims of any kind and nature?
>
> (2) If so, what are the terms of such agreement?" (emphasis supplied)

The Issues of Law provided, *inter alia,* VI (1), (2):

> "(1) Did Defendant as part of its agreement with the estate of Marie A. Caraplis legally obligate itself to *procure insurance* for the benefit of Marie A. Caraplis which would hold said estate harmless from any and all claims of any kind?
>
> (2) If so, are the terms of this contract definite enough for the Court to fix the exact legal liability of the parties?" (emphasis supplied)

At no time did the appellant claim that appellee en-

tered into an oral contract of insurance, or an oral contract to insure appellant's subrogor. The law relating to such contracts, and the acceptable standards of proof, greatly vary from the standards for a contract *to procure insurance.*

Appellee has contended throughout the case that a contract to procure insurance must be proved with the same certainty as an oral contract to insure (See appellee's memorandum to the trial court, and argument of counsel, Tr. 79-84). In support of its position appellee cited to the District Court *Cleveland Oil Co.* v. *Norwich Ins. Society,* 34 Or. 228, 55 Pac. 435 (1898) and *Cerino* v. *Oregon Physicians' Service,* 202 Or. 474, 276 P.2d 397 (1954). Presumably appellee will continue to rely upon these inapposite cases. Neither decision involved a contract to procure insurance; both were concerned with oral contracts of insurance. Both decisions are therefore inappropriate for consideration within the current context.

The *Cleveland Oil Co.* and *Cerino* decisions, if anything, stand for the proposition *(a fortiorari)* that an oral contract of insurance is valid. It would follow that oral contracts *to procure insurance* are likewise valid. Validity and requisite proof are two different matters and that apparently aided in the lower court confusion.

The Oregon law respecting contracts *to procure insurance* has recently been clarified in *Hamacher* v. *Tumy et al,* 222 Or. 341, 352 P.2d 493 (1960). The lower court instructed the jury that a contract to procure insurance had to be proved with the same certainty as a parol con-

tract of insurance. 222 Or. at 346. The Supreme Court reversed and remanded the case, holding that the instruction was prejudicial error. O'Connell, J., speaking for the Court, asserted, 222 Or. at 349:

> "Must the promisee of a contract to procure insurance prove all of the essentials of a contract of insurance with the same specificity that is required of a promisee asserting the existence of a contract of insurance? The instructions to the jury could be taken to mean that plaintiff was required to prove each of the enumerated elements of a contract of insurance by showing that the parties came to an agreement with respect to each of these separate elements.
>
> We are of the opinion that the instructions so interpreted placed upon the plaintiff too heavy a burden of proof. * * *"

It is true that *Hamacher* was concerned with a contract by an insurance broker or agent to procure insurance for a client but that would not distinguish the decision from the case at bar.

The defective instruction was premised upon some unfortunate dictum in *Rodgers Insurance Agency* v. *Andersen Machinery,* 211 Or. 459, 316 P.2d 497 (1957). The *Hamacher* court labeled the language in *Rodgers* as dictum and clearly indicated its disapproval of the "rule" of *Rodgers*. See 222 Or. at 347-348. The Court stated, 222 Or. at 350:

> "The principal vice of the instruction is that it could be considered by the members of the jury as prohibiting them from finding a contract to procure insurance from facts short of an express agreement

> to that effect. There were facts from which a contract to procure insurance could reasonably be implied."

In several decisions approvingly cited by the Oregon Supreme Court, the elements were much less certain than in the instant case, yet the courts held the proof sufficient to establish a contract to procure insurance. See cases discussed 222 Or 353, et seq.

There is no doubt that appellant adduced substantial proof to support its claim, i.e., breach of a contract by appellee to procure insurance for appellant's subrogor. In logic as in law, such proof need be less strict than proof of an oral contract of insurance. A contract to procure insurance may develop from negotiations where agreement by the parties on certain essential elements of the *insurance* contract is not achieved. See *Hamacher* v. *Tumy et al,* supra, 222 Or. at 353, citing, e.g., *Burroughs* v. *Bunch,* 210 S.W.2d 211 (Tex. 1948). Appellant has sufficiently proved its case if it shows that Hill, on behalf of appellee, negotiated a contract with Mrs. Relos, on behalf of the Postal building, whereby Hill, *inter alia,* agreed to procure insurance which would protect the Postal Building from loss arising out of the operations in and about the building by Clean-Rite. This was clearly proved (Tr. 32-44).

It was difficult to determine the basis of the District Court's direction of verdict but presumably, from the argument on motion (Tr. 76-91), the court felt a strict proof of the essentials was required and unsatisfied.

The elements of an *oral contract* of insurance set

down in the *Rodgers,* supra, and *Cleveland Oil Co.,* supra, cases are five in number:

(1) The subject matter must exist;

(2) There must be a risk insured against;

(3) The amount of indemnity must be determined;

(4) The duration of the risk must be known;

(5) The premium must be paid or exist as a valid charge.

Even accepting appellee's premises, *arguendo,* and overlooking the commands of *Hamacher* v. *Tumy,* supra, appellant adduced proof of the essential elements:

(1) The subject matter was clearly the operation of appellee in and about the Postal Building (Tr. 32-44).

(2) The risk insured against was the harm or risk of loss to the owners and operators of the Postal Building arising out of the appellee's operation (Tr. 33, 39, 40, 41).

(3) The amount of indemnity, while not specified, inferably was a sufficient amount to protect the subrogor from harm, limited by the risk.

(4) The duration obviously coincided with the term of the contract, one year (Tr. 34, 35).

(5) The premium or consideration would account for the difference in cost to the subrogor of the previous maintenance contract and that entered into with appellee (the difference between $47.50 and $60.) (Tr. 37).

Clearly appellant provided substantial evidence to convince a jury of the existence and the terms of the contract. A fact question was presented for jury determination and the court erred in directing a verdict.

2. The appellant proved a sufficiently definite contract to indemnify against its own negligence.

It would seem that the learned District Court may have directed its verdict on the ground that appellant had to prove a contract to indemnify against its own negligence with the requisite specificity. Basically, appellant makes two related contentions:

> (1) There is no sufficient evidence upon which the trial court could reach the conclusion that the accident to Ramsey was caused by the negligence of appellant's subrogor.
>
> (2) Even if the court was justified in reaching this conclusion, the contract proved by appellant was sufficiently definite in its terms to be an enforceable contract to insure against appellant's subrogor's own negligence.

Basically, there was insufficient evidence to establish the causative force injuring Ramsey. A lawsuit was filed by Ramsey against the owners and operators of the Postal Building (Tr. 27-28) and the defense was undertaken by appellant when appellee refused the tender of defense. Ramsey's attorney did not testify as to causation but merely said "In my expert opinion, it was a case of dramatic liability that I thought would appeal to a jury" (Tr. 30).

Mr. Hill testified that he examined the accident scene and found that the safety anchor was broken in half, part on the Postal Building and the rest where Ramsey fell (Tr. 56). He found the anchor bolt had been attached to wood he described as "rotten" (Tr. 56). Mr. Hill never heard of jacks (Tr. 60-61-62) a common safety device in the business and presumably his employees did not use them. The eye-bolt on one side of the belt was embedded in the window from where Mr. Hill examined the scene (Tr. 61). Mr. Ken Wicklund, a representative of appellant, also viewed the scene on the day of the accident (Tr. 66). The wood frame of the window was broken and the eye-bolt was missing; there were no jacks in evidence at the scene (Tr. 72).

It is clear from the summary of the evidence presented that appellee's contention in the District Court that the cause of Ramsey's harm was the Postal Building's negligence is unfounded.

Assuming, *arguendo,* that the negligence of the Postal Building caused or contributed to the harm suffered by Ramsey, appellant contends that appellee's contract to procure insurance was proved to include an assurance against any negligence of the Postal Building. The desire of the fiduciaries of an estate to protect assets, such as the Postal Building, is understandable.

Oregon has long established the rule that one may, by contract, be indemnified from the consequences of his own negligence. In *Unitec Corporation* v. *Beatty Safway Scaffold Co. of Oregon,* 358 F.2d 470 (9th Cir. 1966) this Court reversed the Oregon District Court, and

held, *inter alia,* 358 F.2d 479:

> "The district court concluded that the contract was not sufficiently explicit in its indemnification requirements to hold Unitec responsible for Goodyear's acts of negligence. With this conclusion, we are unable to agree.
>
> "In our view, a reasonable reading of the above provisions leads to the conclusion that the indemnification covers claims arising from injury to any other person or property occasioned in whole or in part by any act or omission of Unitec or its agents. The district court concluded, and we agree, that Unitec's acts or omissions were partially responsible for the damages that occurred to Safway's property. By express contractual design, and in the absence of a contrary public policy or unfair bargaining positions, these parties intended a certain result and therefore must be considered as having themselves defined their rights."

Therefore, this Court upheld Unitec's specific agreement to hold the purchaser harmless at all times against any liability, and for all claims, even where occasioned by the indemnitee's negligence. The instant case presents precisely the same question.

In *Unitec,* supra, this court distinguished two early Oregon cases, *Southern Pacific Co.* v. *Layman,* 173 Or. 275, 145 P.2d 295 (1944) and *Glens Falls Indemnity Co.* v. *Reimers,* 176 Or. 47, 155 P.2d 923 (1945) (relied upon by the District Court in the instant case), as decisions where the indemnitor had been free from fault. 358 F.2d at 479. The same distinction would seem to be equally applicable to this case.

Oregon Supreme Court decisions have recognized that persons can enter into agreements exonerating them from the consequences of their own negligence. A bailee has a right by contract, to exonerate himself from liability for loss of goods, resulting from his own negligence. *Irish & Swartz Stores* v. *The First National Bank of Eugene,* 220 Or. 362, 349 P.2d 814 (1960); *Pilson* v. *Tip-Top Auto Co.,* 67 Or. 528, 136 Pac. 642 (1913).

In *Southern Pacific Co.* v. *Morrison-Knudsen Co.,* 216 Or. 398, 338 P.2d 665 (1959) indemnity was permitted for the indemnitee's own negligent conduct under language which was arguably more broad than that relied upon by the District Court below. The court does not re-write agreements clearly expressed between the parties. A clear expression of intention to indemnify the Postal Building for its own negligence is inferable from the evidence in this case and should be upheld under the *Southern Pacific Co.* v. *Morrison-Knudsen Co.,* supra, doctrine. The dependence of one party upon the other seems important there. See 216 Or. at 412. Here appellee's conduct would certainly indicate control over the "injury potential" of the job. Also, the Oregon cases look to disparity or equality of bargaining power as a criterion for enforcement of the agreement. See., e.g., 216 Or. at 418 et seq. Here it is clear that the Postal Building relied upon the expertise of appellee and that the parties were at least co-equal in their bargaining power.

Indemnity for the consequences of one's own negligence was affirmed in other jurisdictions, See, e.g., *Ryan Mercantile Company* v. *Great Northern Rwy. Co.,* 186 F. Supp. 660 (D. Mont. 1960).

It is thus clear that the Oregon law permits an indemnitee to secure indemnity for its own negligence. It remains to examine the evidence presented in the District Court to determine whether appellant presented substantial evidence of such an agreement.

Appellant is cognizant of the factual conflict in the instant case. A review of the evidence favorable to appellant (e.g. Tr. 32-35, 37, 39-40, 41, 43-44, 61-63; Ex. 22) reveals a jury question presented upon the issue of whether or not appellee contracted to procure insurance which would protect the Postal Building from the consequence of its own negligence. The trial court erred in directing a verdict and removing this question from the jury.

Mr. Hill testified that he had a policy with Zurich Insurance Company at the time of the negotiation and at the time of the accident (Tr. 16-18; Ex. 5). He testified that insurance was never discussed by the parties prior to the accident (see, e.g. Tr. 24) but later recanted and admitted considerable discussion about what he called "bond" (Tr. 62-63).

Mrs. Relos, in her fiduciary capacity and as manager of an important asset of the estate, was most concerned about insurance, and her testimony would permit a jury to find that she entered a contract with appellee whereby appellee promised to procure insurance which would indemnify the Postal Building, *inter alia,* from the consequences of its own negligence (See Tr. 32-44 generally).

Mrs. Relos testified that Mr. Hill told her he would

charge more because his clients would be completely covered or insured (Tr. 32):

> "At any rate, his fee was more, and I asked him why, and he said because he carried such extra heavy insurance to cover us in any circumstances which might arise." (Tr. 33)

Mrs. Relos also testified:

> "* * *. And he said, 'For the insurance that I carry, you would be covered for any type of situation that might arise.'
>
> And this is what impressed me." (Tr. 33)
>
> * * * * *
>
> "He said that one reason that his charge was more was because he had to pay extra for such heavy insurance to protect the people that he work for." (Tr. 39)
>
> * * * * *
>
> "Q. And he had indicated to you he had Workman's Compensation, didn't he?
>
> A. Yes, and extra coverage, too, with Zurich Company and others.
>
> Q. With regard to what?
>
> A. Any accident that might arise or anything; * * *." (Tr. 40)
>
> * * * * *
>
> "A. He said that we would be completely covered if anything arose that was wrong that would hurt us; anything wrong he would have the complete insurance coverage, and that is all I was interested in.
>
> Q. So far as his operations were concerned you were fully protected?
>
> A. Yes." (Tr. 40)
>
> * * * * *

"A. He told me that he carried a type of bond. Now—a type of bond, and he carried this Zurich, with the Zurich Company, and he told me that it just covered extra insurance.

And I asked him, 'Why do you charge more than—' most window washing companies charge about the same. And he said because of the extra coverage he carried, and that is why he had to charge more, but in turn the people that had his services were covered more." (Tr. 41)

There is no doubt that appellant's evidence presented a jury question on the existence and terms of the contract of insurance appellee promised (and failed) to procure. The District Court erred in taking the case from the jury.

CONCLUSION

The district court's direction of a verdict against appellant and in favor of appellee was clearly erroneous and should be reversed. Appellant's evidence presented a jury question upon the issue of the terms of a contract by appellee to procure insurance to protect appellant.

Respectfully submitted,

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CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

JAMES H. BRUCE
Of Attorneys for Appellant

No. 21015

United States
COURT OF APPEALS
For the Ninth Circuit

MARYLAND CASUALTY COMPANY,
a Maryland Corporation,

Appellant,

v.

CLEAN-RITE MAINTENANCE COMPANY,
an Oregon Corporation,

Appellee.

APPELLEE'S BRIEF

Appeal from the United States District Court for the District of Oregon

HONORABLE BRUCE R. THOMPSON, District Judge

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Appeal from the United States District Court
for the District of Oregon

HONORABLE BRUCE R. THOMPSON, District Judge

JURISDICTION

Appellee adopts the appellant's statement of jurisdiction which adequately shows the jurisdictional basis of the appeal.

STATEMENT OF THE CASE

The appellee accepts the Statement of the Case set forth in appellant's brief, but desires to enlarge upon the same in a few brief particulars.

Mr. Victor J. Hill, President of the defendant Clean-Rite Maintenance Company (Tr. 12) testified as witness for plaintiff that in 1963 he had discussed with Mrs. Relos, manager of the Postal Building (Tr. 31), the question of cleaning windows for the Postal Building, she asked for a quotation, and he met her once or twice before he actually did the work (Tr. 11). He gave her a quotation on a one-time basis, there was no contract (Tr. 11), and a subsequent proposed agreement for a bimonthly cleaning of the building was sent to Mrs. Relos after the initial cleaning of the building (Tr. 13). On the only occasion that Clean-Rite did clean the windows of the Postal Building, Clean-Rite's employee, Lee Ramsey, fell from the fourth floor on June 12, 1963, and was injured (Tr. 10). After the fall and the injury to Mr. Ramsey, he sent on August 6, 1963, a written outline of a proposed agreement to Mrs. Relos (Tr. 15) which was entered as Plaintiff's Exhibit 1 (Tr. 47). This agreement read: "We carry Workmen's Compensation $100,000 and $300,000, contractor's public liability and $100,000 third party property damage, insurance to protect you in case of accidents. All of our employees are covered under our $10,000 blanket fidelity bond." (Tr. 16). At the time he first talked to Mrs. Relos in the spring of 1963, he had a public liabil-

ity policy with Zurich Insurance Company (Tr. 17) entered as Plaintiff's Exhibit 5 (Tr. 18).

Mrs. Charlotte Relos testified for plaintiff that during her first conversation with Mr. Hill in 1963 he told her he carried extra insurance with the Zurich Insurance Company, and that is why he had to charge a bit more (Tr. 32). At this time the Postal Building was covered by a liability insurance policy issued by appellant (Tr. 31), with $100,000 protection from 9/22/62 to 9/22/65 (Tr. 71).

On cross-examination Mrs. Relos stated that Mr. Hill told her they would be completely covered if anything arose, and so far as his operations were concerned, she was fully protected (Tr. 40). He told her he had a type of bond and extra insurance with Zurich, and this was the extent of their conversation outside of the fact they were going to have a written contract, but there never was a written contract (Tr. 41). She wrote a letter on August 29, 1963, to Mr. Hill at Clean-Rite Maintenance Company, stating in part that "it occurs to me now in view of your earlier comments about insurance that the Postal Building might be covered for this claim under your insurance policies" (Tr. 43).

Victor J. Hill testified for defendant that he was on the scene of the accident about thirty minutes after it had happened (Tr. 55), and that his inspection revealed that the wood the anchor bolt was attached to was rotten, and the bolt pulled out of the building (Tr. 56). The words in his advertisement in the telephone books "fully insured for your protection" meant there

was protection against his employees' act such as stealing, but it did not mean to cover anything that occurs through the fault of the building owner, he could not cover a third party for negligence on their part (Tr. 59).

Kenneth A. Wicklund, a claim adjuster for Maryland Casualty Company, took a statement from Mrs. Relos on June 13, 1963, at which time there was no mention by Mrs. Relos about any insurance coverage being provided by defendant (Tr. 67). He took a further statement from Mrs. Relos on August 1, 1963, which stated: "Nothing was ever said by either one of us in which we used the words 'hold harmless agreement'," and that is what Mrs. Relos related to him at that time (Tr. 70). He examined the room from which Mr. Ramsey fell, and noticed the wood frame on the outside of the building was broken, the I-bolt was missing because it had remained fastened to Mr. Ramsey's belt (Tr. 71-72).

In counsel's arguments on the motion for directed verdict, the court asked counsel for plaintiff what he thought the most favorable view of the evidence shows with respect to what this contract was (Tr. 86), and plaintiff's counsel informed the court that he thought the most favorable view to the plaintiff is that Mr. Hill on behalf of Clean-Rite promised he had and would procure insurance to protect and hold harmless the Postal Building, its owners and operators, from any harm or damage which might befall anyone in or around the Postal Building, related to Mr. Hill's company's operations in washing windows (Tr. 86).

SUMMARY OF ARGUMENT

The District Court did not err in granting a directed verdict in favor of the defendant, on the grounds that the plaintiff did not prove with substantial evidence the terms of a contract of insurance or to procure insurance which would indemnify the plaintiff's insured for its own acts of negligence. There is no distinction made in Oregon law as to the legal requirements to enforce an oral contract of insurance or to insure.

The defendant will also contend that plaintiff did not have standing to bring an action for subrogation, as the equities did not preponderate in favor of the plaintiff as to entitle it to pursue a subrogation claim.

In addition defendant will contend that an oral contract to indemnify another against his own negligence is not enforceable unless such intention to indemnify is expressed in clear and unequivocal terms.

ARGUMENT

1. A material issue must be proved with substantial evidence without conjecture and speculation, before a jury question is presented.

It is elementary that in this case, as in any other case, before a plaintiff can make a jury question upon a material issue, there must be presented substantial evidence on this issue which will not require the jury to resort to conjecture and speculation. This concept, of course, becomes important in a case of this nature where the plaintiff is claiming that the trial court erred in determining there was insufficient evidence as

a matter of law to establish plaintiff's case, which, therefore, precluded the submission to the jury of this purported insurance agreement. On this subject the Oregon Court has stated:

> ". . . What is required is evidence from which reasonable men may conclude that, upon the whole, it is more likely that there was negligence than that there was not. Where the conclusion is a matter of mere speculation or conjecture, or where the probabilities are at best evenly balanced between negligence and its absence, it becomes the duty of the court to direct a jury that the burden of proof has not been sustained. . . . The quotation is directed to decisions on negligence but it is applicable to the proof of any fact. . . ." *Beeler* v. *Collier,* 80 Or. Adv. Sh. 411, 412-413, — Or. —, 400 P.2d 541.

Therefore, regardless of whether the plaintiff is relying upon the contract to procure insurance, or was required to establish the terms of a contract of insurance, it was incumbent upon the plaintiff to prove some substantial evidence as to just what type of insurance burden he contended the defendant had undertook to assume. It is the appellee's position that there was no such substantial evidence, and that the trial court properly removed this element from the jury's consideration and ordered a directed verdict, because of this failure of proof.

2. The appellate court can examine sufficiency of all grounds presented in defendant's motion for directed verdict, in addition to the ones relied upon by trial court.

While the main thrust of this appeal will be directed

to the lack of proof by plaintiff of the alleged agreement to insure Postal Building for its own negligence in maintaining an unsafe place for defendant's employee to work, as will be seen at (Tr. 76, et seq), defendant also contended in the directed verdict motion that the plaintiff was not entitled to subrogation. The appellee also intends to bring this lack of right to subrogation before this court, and is entitled to do so by Oregon law even though the trial court did not pass upon this ground. Authority for this proposition is set forth as follows:

> "The plaintiff's sole assignment of error is the action of the trial court in directing a verdict for defendant. The trial court ruled that the evidence was insufficient to raise a question of fact, to be determined by the jury, as to negligence or non-negligence of the defendant. Since the defendant's motion to direct a verdict included other grounds than the one ascribed by the trial court for its action, it is necessary to consider each ground of the motion." *Oregon Mutual Fire Insurance Company, et al v. Mathis*, 215 Or 218, 220-221, 334 P2d 186.

3. Directed verdict in favor of defendant was proper because plaintiff did not have standing as a subrogee to maintain this action in the trial court.

It will be seen from Item (5) of "Plaintiff's Contentions", Page 3 of the Pre-Trial Order in this case, that plaintiff claimed:

> "That plaintiff is subrogated to all the rights of the estate of Marie A. Caraplis against the defendant, if there is a right of subrogation under the facts of this case."

It will also be seen that under "Defendant's Contentions", Item (1), that the defendant claimed:

> "Plaintiff is not entitled to subrogation under the circumstances of this case."

The right of subrogation in Oregon is not absolute, but is modified by equitable principles. The Oregon Supreme Court has stated:

> ". . . True subrogation only lies where one secondarily liable pays the debt of another and not where one primarily liable pays his own debt." *Newell* v. *Taylor,* 212 Or. 522, 532, 321 P.2d 294 (citing *American Surety Company* v. *Bank of California* (9th Cir. D.C., Or.) 133 F.2d 160).

The Ninth Circuit case relied upon by the Oregon Court in *Newell* v. *Taylor,* stated the rule as follows:

> "The right of subrogation is a creature of equity, applicable where one person is required to pay a debt for which another is primarily responsible, and which the latter should in equity discharge. In theory one person is substituted to the claim of another, but only when the equities as between the parties preponderate in favor of the plaintiff. That is, a surety's right of recovery from a third party through subrogation does not follow, as of course, upon proof that the losing but recompensed party could have recovered from the third party. Accordingly, subrogation will not operate against an innocent person wronged by a principle's fraud. A surety may pursue the independent right of action of the original creditor against a third person, but it must appear that the said third person participated in the wrongful act involved or that he was negligent, for the right of recovery

from a third person is merely conditional in contrast to the right to recover from the principle which is absolute. The equities of the one asking for subrogation must be superior to those of his adversary. If the equities are equal or if the defendant has the greater equity, subrogation will not be supplied to shift the loss." (Page 162 of the Opinion).

This case went on to say:

"Since Insurers expressly volunteered and for a compensation guaranteed against loss in the exact situation involved, the equity in the situation cannot lie in favor of the Insurers and against the Bank for the payment made." (Page 164 of the Opinion).

The case finally determined that the plaintiff had no right of subrogation.

In the case at bar Maryland Casualty Company expressly volunteered and "for a compensation guaranteed against loss in the exact situation" which was involved in this case. We feel it is somewhat fortuitious for appellant to claim that there was not sufficient evidence of negligence of the operators of the Postal Building (App. Br. 14). In fact it was undisputed, and confirmed by Mr. Wicklund, appellant's own insurance claim adjuster, that the I-bolt being used by Mr. Lee Ramsey pulled out of the rotted woodwork of the building, causing him to fall to the ground. Now the appellant is trying to avoid its primary duty for which it had received a premium, and shift it *in toto* to the appellee, who had no participation in the negligent act

involved, but whose only contact with appellant's insured was some vague allegations that there was full insurance for the protection of the Postal Building. Appellant apparently did not pay the sum of $22,500 to Mr. Lee Ramsey, if it did not feel there was primary liability on the part of its insured, and being the primary target of this threatened action by the injured employee, this appears to be a good example of a case where "subrogation will not be supplied to shift a loss."

4. Appellant failed to introduce substantial evidence of a contract of insurance, or the terms of insurance contract to be procured by appellee.

The fact that appellant is claiming appellee agreed to insure and indemnify it against appellant's insured's own negligence will be discussed in the next argument. Appellant attaches a great deal of importance to the fact there must be some arcane distinction between a contract of insurance, and a contract to procure insurance. If there is a distinction, and the words "to procure" have some recondite significance, the appellee asks the question, "to procure *what* insurance"? If the appellant had ordered some special window glass from India, for example, and the glass fell from a barge in the Ganges River, did the appellee insure against this loss? Surely the terms must have some certainty so that a court and jury can determine what burden was undertaken by the appellee, we stretch the bounds of common sense to contend that some "puffing" about the insurance program carried by appellee bound him to insure the appel-

lant for every possible and foreseeable risk which might ensue. Regardless of the semantics, the Oregon Court has long recognized that a contract to insure must be proved with the same certainty as is necessary to prove a contract of oral insurance. The Oregon Court has stated:

> "In order to make a valid contract of insurance," says Mr. Wood, in his work on fire insurance (Second Edition), Sec. 5, "several things must concur: "First, the subject matter to which the policy is to attach, must exist; second, the risk insured against; third, the amount of indemnity must be definitely fixed; fourth, the duration of the risk; and, fifth, the premium or consideration to be paid therefore must be agreed upon, and paid, or exist as a valid legal charge against the party insured where payment in advance is not a part of the condition upon which the policy is to attach. The absence of either or any of these requisites is fatal in cases where a parol contract of insurance is relied upon. It is not the duty of courts to make contracts for parties, but to interpret the engagements they have undertaken and, in view of this legal principle, the rule is well settled, that, before a contract of insurance *or to insure* can become binding, all these necessary elements must be understood, assented to and agreed upon, either expressly or by implication, before there can be an absolute binding obligation between the parties." *Cleveland Oil Co.* v. *Insurance Society,* 34 Or. 228, 233-234 (emphasis supplied)

More recently the Oregon Court has said:

> ". . . If the contract in any case is so indefinite as to make it impossible for the Court to decide just what it means, and fix exactly the legal liabil-

> ity of the parties, it cannot result in an enforceable [sic] contract . . ." *Landgraver* v. *DeShazer,* 239 Or. 446, 447, 398 P.2d 193.

It will be noted that at (Tr. 87) the trial court questioned counsel for appellant as to how much insurance appellee had to provide, and counsel indicated sufficient insurance to cover any loss or harm. Suppose for example instead of a rotting window frame giving away, a whole side of the building had collapsed at the same time killing and injuring hundreds of people with damage claims in the millions—did appellee accept this burden merely by claiming "fully insured for your protection?" Or if the entire building was destroyed by fire at this time, did Mr. Hill promise to "procure" insurance to cover the loss?

On page 9 of Appellant's Brief are set forth two or three portions of the pre-trial order, and it is seen that the issues of fact included "(2) If so, what are the terms of such agreement?" The same page also sets forth the issues of law which were stated to be "(2) If so, are the terms of this contract definite enough for the court to fix the exact legal liability of the parties?" That is what this case is all about, if the appellee contracted to undertake the vast burden referred to by the appellant, what does the trier of fact have to work with to determine the appellee's responsibility for the terms of this purported agreement. For example, in Oregon since 1952 in the case of *Oregon Auto Insurance Company* v. *United States Fidelity and Guarantee Company*

(9th Cir., D.C. Or.), 195 F.2d 958, the Court of Appeals for the Ninth Circuit recognized that when two automobile liability insurance policies cover the same risk, they pro-rate their share of the risk in proportion to their coverage limits. While this refers to an automobile policy, there seems no logical reason why this doctrine should not extend to any case where two liability policies cover the same risk. Of course, this doctrine of pro-rating insurance policies is well adopted in Oregon in the case of *Lamb-Weston, Inc., et al* v. *Oregon Auto Insurance Company* (1959), 219 Or. 110, 341 P.2d 110, 346 P.2d 643. Had this point ever been reached in the trial, the appellee was going to contend that its liability, if any, should pro-rate with the $100,000 liability policy carried by appellant. [This point was discussed by counsel for appellee (Tr. 84).] But in what proportion? Without some evidence of the terms of the policy agreed upon there is nothing to substantiate as to how much the appellee or the appellant should contribute to this risk.

Assuming there is some merit in plaintiff's contention that all that is involved here is a contract to procure insurance, there is not a scintilla of evidence that appellee ever agreed to procure insurance. All Mrs. Relos testified to over and over again was that the appellee told her he was well insured and that is why his rates maybe were a little higher. If she relied upon the advertising in the telephone book, all it said was "fully insured for your protection." In fact, Mrs. Relos on cross-examination stated Mr. Hill told her they would be completely covered if anything arose and that

"so far as his operations were concerned, you were fully protected" (Tr. 40). It will be seen at (Tr. 41) that this conversation about the type of insurance he carried was the sole substance of their conversation on this point. And, of course, this is exactly true, that as far as Mr. Hill's operations were concerned, she was fully protected. For example, if Mr. Lee Ramsey negligently dropped a bucket on the head of a passerby, his insurance with Zurich-American Insurance Co. was available to protect the Postal Building. Mr. Hill wrote to her after the accident to confirm their agreement in writing, and pointed out at (Tr. 16):

> ". . . we carry Workmen's Compensation, $100,000.00 and $300,000.00, contractor's public liability and $100,000.00 third party property damage, insurance to protect you in case of accidents. All of our employees are covered under our $10,000.00 blanket fidelity bond."

But it wasn't *his* operations that brought any insurance policy into play in this case, it was the negligence of the Postal Building operators that brought Maryland Casualty Company into the picture to face its primary duty as the liability insurer for the negligent acts of the operators of the Postal Building. Appellant has not pointed to any specification of evidence where Mr. Hill contracted to go out and "procure insurance," their entire conversation was directed to his existent insurance program. The very word "procure" is couched in the future tense, and defined as "to get or obtain," "to cause or bring about." Mr. Hill never agreed to go out and buy insurance for Mrs. Relos, merely pointed out that he was in-

deed "fully insured for your protection," but, of course, only as to his own faults. As Mr. Hill pointed out, he could not cover a third party for negligence on their part (Tr. 59). The appellant admits in his brief at page 13, that appellant only adduced proof that the risk or harm insured against was harm or risk "arising out of the appellee's operation." That is exactly why appellee carried its liability policy. But the harm in this case arose out of appellant's own neglect, not "appellee's operations."

Another interesting point not raised by appellant is the fact that during the entire time she was discussing this window cleaning job with Mr. Hill, Mrs. Relos had her own $100,000 liability policy with Maryland Casualty Co. effective 9-22-62 to 9-22-65 (Tr. 71). Obviously if she was so vitally interested in Mr. Hill's insurance program, this interest did not extend to her own liability, which was fully protected. It seems sheer sophistry for her subrogee to now come into court in her shoes claiming she relied upon Mr. Hill to indemnify her for her own negligence, when she was adequately protected at all times relevant in these proceedings.

Regarding appellant's contention at page 13 of appellant's brief, that the premium can be computed by taking into account the previous maintenance contract, it should be pointed out that Mr. Hill's price included cleaning the windows at Mrs. Relos' private residence (Tr. 23). There is not a word in the record that any consideration ever changed hands to support this purported agreement.

In sumary, therefore, whether the appellant was required to establish by substantial evidence the terms of this purported oral contract of insurance, or only to establish a contract to insure, before it can become binding upon the appellee there must be some proof of the terms in order that justice can be done by our courts of law. The *Cleveland Oil Company* v. *Insurance Society* case, supra, was more recently cited with approval in *Cerino* v. *Oregon Physicians Service,* 202 Or. 474, 484-485, 276 P.2d 397, where the Oregon court said:

> "When a parole contract of insurance is relied upon to sustain a recovery of damages resulting from a breach of the agreement, or to enforce a specific performance of the terms which have been mutually assented to, the existence of the contract must be conclusively established."

The appellee contends this was one of the burdens of the appellant in this case, and the trial court properly determined that this burden had not been met, and that a directed verdict was proper in favor of the appellee.

5. In the absence of explicit agreemnt an indemnity agreement will not be construed to save the indemnitee harmless from his own negligence.

The appellant claims at page 14 of Appellant's Brief that the appellant proved a sufficiently definite contract to indemnify against its own negligence. The appellant is saying in substance in this case, that the appellee agreed to procure insurance to protect the estate from all claims, which is in essence a form of indemnity

or "hold harmless" agreement. Initially it might be noted at (Tr. 70) that Mrs. Relos gave a statement to the insurance adjuster for the appellant on August 1, 1963, shortly after the accident, that "now, nothing was ever said by either one of us in which we used the words 'hold harmless agreement.' "

Regarding the type of proof necessary to establish that a person agrees to indemnify another from that person's own acts of negligence, the Oregon court has said:

> "It is a firmly established rule that contracts of indemnity will not be construed to cover losses to the indemnitee caused by his own negligence unless such intention is expressed in clear and unequivocal terms. In Perry vs. Payne, 217 Pa. 252, 262, 66 Atl. 553, 11 LRA (NS) 1173, the court said: 'We think it clear, on reason and authority, that a contract of indemnity against personal injuries should not be construed to indemnify against the negligence of indemnitee unless it is so expressed in unequivocal terms. The liability on such indemnity is so hazardous, and the character of indemnity so unusual and extraordinary, that there can be no presumption that the indemnitor intended to assume the responsibility unless the contract puts it beyond doubt by express stipulation. *No inference from words of general import can establish it.*" (Emphasis supplied) *Southern Pacific Co.* v. *Layman,* 173 Or. 275, 279, 145 P.2d 295.

While we agree that Oregon Supreme Court decisions have recognized that persons can enter into formal agreements exonerating them from the consequences of

their own negligence, this is such a hazardous undertaking that all courts, including Oregon, are extremely reluctant to find such an agreement of indemnification unless there is a very high degree of proof that this was the party's intent. Again using a somewhat attenuated argument to underscore this problem, suppose Mrs. Relos had gone to India to obtain the window glass referred to in appellee's arguments above, and had negligently dropped a piece of glass on the Calcutta salesman's foot —did Clean-Rite Maintenance Company insure her for this act of negligence? It will be seen from (Tr. 90) that the trial court was well apprised of this rule of law, and cited the case of *Glens Falls Indemnity Company* v. *Reimers,* 176 Or. 47, 155 P.2d 923, in which case there was a written indemnity agreement containing the following language:

> "The contractor assumes all responsibility for damage to property or persons and will save and hold harmless the company, its officers, agents and employees from all liability for personal injury and from costs, charges or expense reasonably incurred by the company on account of such damages, injury or claims, therefor which may arise or result from the performance, non-performance or mal-performance of this contract."

In spite of this written contract with a written indemnity agreement, the Supreme Court held it would not be construed to indemnify the indemnitee against the consequences of its own negligence. The appellee is also of the opinion that in the case of *Unitec Corporation* v. *Beatty Safway Scaffold Company,* 358 F.2d 470

(9th Cir. 1966), cited by appellant, this court construed the agreement involved to include indemnification for the indemnitee's negligence, because the indemnitor had in the same agreement agreed to procure a policy of liability insurance. Both the trial court and this court also concluded that the indemnitor in the *Unitec* case was partially responsible for the damages that incurred, whereas in the case at bar the only proof in the record indicates that it was the indemnitee's own acts of negligence that gave rise to this entire proceeding, and in which no fault was shown on the part of appellee.

Counsel for appellant's own version at the trial of what his case was all about strikingly underscores the fact that there never was any claim that appellee agreed to indemnify the Postal Building for its acts of negligence. As will be seen at (Tr. 86), the following occurred:

> "The Court: You tell me what you think the most favorable view of the evidence shows with respect to what this contract was.
>
> Mr. Foley: I think the most favorable view to the plaintiff, your Honor, is that Mr. Hill, on behalf of Clean-Rite, promised that he had, and would procure during the term of this one-year window washing agreement, insurance to protect and hold harmless the Postal Building, its owners and operators, from any harm or damage which might befall any one in or around the Postal Building, *related to Mr. Hill's company's operations in washing windows.*" (emphasis supplied)

And yet there never was any proof that any harm or damage resulted from Mr. Hill's "operations," the harm

resulted from the negligence of the Postal Building, in having window-washing I-bolts attached to rotted woodwork which gave away. Appellant's own counsel, therefore, admits that after hearing the evidence most favorably to the appellant, there was no proof that there would be any indemnification for the negligence of the Postal Building. Mr. Hill had adequate insurance to protect from harm resulting from his own operations (Tr. 16), and the trial court properly refused to submit this case to the jury. As was said in *Southern Pacific Company* v. *Layman,* supra, when referring to an indemnity agreement being construed to cover losses to the indemnitee caused by his own negligence, "no inference from words of general import can establish it." All we have in this case is some "puffing" by Mr. Hill that he had a full insurance program available. Indeed he had, but there was no proof of the drastic and hazardous type of indemnification agreement sought to be established by appellant herein.

CONCLUSION

Appellant has three hurdles to overcome before this Court can say that there has been reversible error in this case. First there must be a showing that the appellant is entitled, as a condition precedent to bringing this action, to the right of subrogation. There is respectable Ninth Circuit and Oregon authority that one is entitled to subrogation "only when the equities as between the parties preponderate in favor of the plaintiff." The plaintiff in this case, Maryland Casualty Company, for

a premium issued the policy insuring against exactly the type of harm which occurred in this case, i.e., stemming from the negligence of the owners of the Postal Building. Appellee contends that this is a perfect example of a case where, "if the equities are equal or if the defendant has the greater equity, subrogation will not be supplied to shift the loss." *American Surety Co.* v. *Bank of California,* supra)

If appellant is entitled to subrogation, then the appellant had to show by substantial evidence that appellee agreed in some manner to also insure the operators of the Postal Building for every type of risk which possibly could be imagined, according to the pre-trial order and appellant's contentions in its brief. If there is some merit to appellant's position that a contract "to procure" insurance has some vital distinction from a contract to enforce an oral contract of insurance, there still must be some terms of this alleged contract shown to apprise the appellee of what he was facing. Yet at the trial, appellant proved nothing except that the appellee had told Mrs. Relos that he was fully insured. Mrs. Ralos summarized their entire conversation by stating Mr. Hill contended "so far as *his operations* were concerned, you were fully protected" (Tr. 40). At the trial on the argument for motion of directed verdict, plaintiff's counsel took the same position, that the Postal Building was protected from actions "related to Mr. Hill's company's operations in washing windows" (Tr. 86). Yet the injury which gave rise to this law action arose from the "operations" of the Postal Building—at

all times Mr. Hill was insured for his own operations. It is somewhat cynical for Mrs. Relos to contend that Mr. Hill was promising to insure her for her own negligence, rather than his own acts, when at all times the subject of insurance was being discussed with Mr. Hill, she carried her own $100,000 liability policy with appellant.

Finally, appellant must show that the appellee had undertaken the extreme burden of agreeing to provide an indemnity policy of insurance, saving the Postal Building harmless for its own acts of negligence. When it comes to such extraordinary agreements, the Oregon court has recognized that the liability on such indemnity is so hazardous, and the character of indemnity so unusual and extraordinary, that "no inference from words of general import can establish it" (*Southern Pacific Company* v. *Layman,* supra, page 279). These words could have been written with this case in mind, the only proof adduced by appellant at the trial was a conversation or two between Mrs. Relos and Mr. Hill to the effect that she would be fully insured from his operations, and these are only words of "general import."

The trial court properly refused to submit this case to the jury.

Respectfully submitted,

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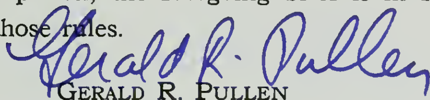
CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.



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No. 21015

United States
COURT OF APPEALS
for the Ninth Circuit

MARYLAND CASUALTY COMPANY,
a Maryland corporation,

Appellant,

v.

CLEAN-RITE MAINTENANCE CO.,
an Oregon corporation,

Appellee.

APPELLANT'S REPLY BRIEF

Appeal from the United States District Court for the District of Oregon

HONORABLE BRUCE R. THOMPSON, District Judge

FILED

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APPELLANT'S REPLY BRIEF

Appeal from the United States District Court
for the District of Oregon

HONORABLE BRUCE R. THOMPSON, District Judge

ARGUMENT

1. Appellant produced substantial evidence presenting a question for jury determination.

Appellee's statement of the case (Br. 2-4) and first argument (Br. 5-6) set forth accepted legal propositions. However, appellee's attempts to mold the facts of this case into support for the District Court's ruling are tortured. Its statement of the case stresses Mr. Hill's

testimony to the exclusion of that of Mrs. Relos. Because the issue on appeal is whether the appellant produced substantial evidence, productive of a jury question, the evidence should be viewed in a light most favorable to the appellant and most strictly against the movant-appellee. *Allister* v. *Knaupp, et al,* 168 Or. 630, 642-643, 126 P.2d 317 (1942). It is uncontested that the testimony of Mr. Hill and Mrs. Relos was diametrically opposed; the numerous factual issues thus formulated should have been considered by the jury.

Appellee's quotation (Br. 6) from Professor Prosser, cited by the Oregon Supreme Court in *Beeler* v. *Collier,* 240 Or. 141, 400 P.2d 541 (1965), seems strangely anachronistic, concerned as it is with circumstantial evidence in a negligence case. A simpler, more appropriate statement of the applicable rule is that the appellant must produce substantial evidence of a contract by the appellee to procure insurance in favor of appellant, and there is insufficient evidence where the jury must speculate. A review of the evidence in this case, as excerpted in appellant's opening brief, indicates the appellant has satisfied its burden.

2. Appellate examination of a contention not considered by the trial court.

Appellee's second argument (Br. 6-7) attempts to justify the unnecessary cluttering of an appellate brief with matters not considered by the trial court, and is a requisite foundation for appellee's third argument concerned with appellant's right to subrogation (Br. 7-10).

The District Court apparently did not rule on, or consider, the "subrogation" argument.

Appellant believes that the availability of a previously unconsidered matter on appeal is a matter of Federal, not Oregon, law; therefore the citation of *Oregon Mutual Fire Insurance Company et al* v. *Mathis,* 215 Or. 218, 334 P.2d 186 (1960) (Br. 7), is interesting but uncontrolling. Whether or not this Court will review matters not considered by the District Court is a consideration of internal appellate procedure, governed by the rules of this Court.

Nevertheless, appellant will comment upon the merits of appellee's "subrogation" argument advanced under this justification, despite doubts as to the propriety of the procedure, in the succeeding section.

3. Appellant had standing to sue as subrogee.

Appellee asserts that appellant had no standing as a subrogee to maintain this action. Appellee's argument on this point is not a model of precision and clarity; apparently appellee believes that appellant does not have "superior equities" and is not entitled to subrogation.

Firstly, in support of its position, appellee relies upon *Newell* v. *Taylor,* 212 Or. 522, 321 P.2d 294 (1958), which states a broad principle as a matter of dicta, and relies upon *American Surety Company* v. *Bank of California,* 133 F.2d 160 (9th Cir. 1943).

In *American Surety Co.,* supra, Interior Warehouse Company was a depositor of the defendant bank. Inte-

rior's bookkeeper, Crowe, fraudulently made checks to improper or nonexistent persons, forged the payees' names, cashed the checks, and converted the funds. He falsified Interior's records to cover his defalcations. American Surety insured Interior against employee infidelity. American Surety paid Interior the amount of loss caused by Crowe's embezzlement and took an assignment of Interior's claims against the Bank. In this action, American Surety sought to recover from the Bank the payments made to Interior. Judgment for the Bank was affirmed by this Court. American Surety contended that the Bank became contractually liable to Interior by charging Interior's account with fraudulently endorsed checks. Appellee avoids citation of the following paragraph, which distinguishes *American Surety Company, supra,* from the instant case, 133 F.2d at 163:

> "The basic principles set forth above are consistently reiterated in connection with the right of subrogation, and are clearly supported by the majority of reported decisions. The cases, dealing with the surety's alleged right of subrogation to the claim of the original creditor against the third party with whom the indemnitor is not in privity, indicate that the result reached depends upon a careful analysis of the facts involved. Obviously, we do not have before us an indemnity agreement running to any person injured, as so often appears in surety contracts of public officials, rather than to specifically named persons. Cases with the turning point as to subrogation correctly or incorrectly resting upon that fact should not be allowed to confuse the situation. The same may be said as to many opin-

> ions to be found in the books which erroneously, as we think, fail to note that the touchstone upon which subrogation, as to parties not under contractual obligations between themselves, depends is the superior equity between the surety and the claimed subrogee."

The *American Surety Co., supra,* decision is clearly inapposite. Appellant has a claim as subrogee because the primarily-liable party was the appellee-obligor under the latter's agreement with the subrogor to procure insurance in favor of the subrogor to protect it in the event of an incident like the Ramsey accident. If appellant's theory is adhered to (and the case was tried on this theory), then *American Surety Co., supra,* is specifically distinguished by its own terms. The present case is concerned with an "indemnity agreement running to an injured person" and a "contractual obligation between the parties."

Secondly, it is difficult to comprehend appellee's contention that the equities preponderate in its favor. How is appellee as an "innocent person" (Br. 8) wronged by another's fraud? Under appellant's theory and proof, appellee secured a valuable contract from appellant's subrogor by an agreement to procure insurance to protect the subrogor. It would be strange, indeed, to allow the appellee to make such a promise, breach the contract, thrust the loss upon the subrogor, and then contest the standing of the subrogee to seek to enforce the contract. Even more bizarre is the instant case where the appellee contends that the trial court was justified in

refusing to submit the factual questions raised to a jury determination.

Assuming, *arguendo,* that appellee's authorities control the instant case, appellee cannot prevail unless it is clear that appellee was not negligent and did not engage in any wrongful act. The evidence in the instant case regarding negligence is sparse; negligence was a collateral issue. It is certainly inferable that the cause of the Ramsey injury was not solely a breach of duty on the part of appellant's subrogor. Ramsey was employed by the appellee, which was presumably expert in the commercial window washing field. There was no showing that the appellant-subrogor (decedent's estate), or its managers (the co-executrices), had any knowledge or expertise regarding the window-washing profession or the state of the building (an estate asset). Ordinarily, when one comes to an existing structure to perform a function as an independent contractor, he is bound to look out for his own safety and he takes the building as he finds it. The failure to do so is negligence which would be causative of the Ramsey harm.

Appellant's subrogor was a landowner. A landowner is not an insurer of safety, even as to the employees of persons working upon the buildings or premises. A landowner need not guard against the mere possibility of accident, but merely should protect against such risks which a reasonably prudent person in the position of landowner would anticipate. *Eberle* v. *Benedictine Sisters of Mt. Angel, et al,* 235 Or. 496, 504, 385 P.2d 765 (1963). (Dissenting opinion.) There is no showing that

Mrs. Relos knew anything of the mechanics of window washing, nor is there evidence that the average landowner or building owner would possess such expertise. It is more likely that Mr. Hill's expertise was the subject of Mrs. Relos' reliance. Moreover, a landowner is not charged with negligence in the failure to discover and remedy hazards on his property which were not discoverable in the exercise of reasonable care. *Stuhr* v. *Berkheimer Co.,* 220 Or. 406, 411, 349 P.2d 665 (1960). There is no evidence that appellant's subrogor knew, or had reason to know, that the Postal Building posed any hazard (if indeed it did) in the window-washing maintenance. After all, Associated Building Maintenance had been washing the Postal Building windows for some time previous to the Ramsey accident, apparently without incident.

Thirdly, it seems to be appellee's contention that appellant is not entitled to subrogation because it was a compensated insurance company and paid the Ramsey claim as a risk encompassed by its policy. This bootstrap argument is also unappealing. A compensated surety, for example, is entitled to the same rights and privileges as a gratuitious surety. *In re Liquidation of Bank of Woodburn,* 149 Or. 649, 655, 42 P.2d 740 (1935); *Fidelity & Deposit Company of Maryland* v. *State Bank of Portland, et al,* 117 Or. 1, 7, 242 P.2d 823 (1926).

Apparently appellee asserts that appellant did not have a superior equity under appellee's concept of subrogation. Appellant contends that appellee contracted to

procure insurance for appellant's subrogor, which insurance would provide primary coverage for occurrences such as the Ramsey incident. Upon failure of the appellee to honor its agreement, appellant, under a much broader policy, was forced to indemnify and defend its subrogor. If appellant is correct in these premises (discussed under Arguments 4 and 5, infra) then it would be "secondarily liable" and appellee "primarily liable" under appellees' own terminology, and appellant would be entitled to subrogation thereunder.

4. Appellant introduced substantial evidence of a contract to procure insurance.

Appellee's fourth argument (Br. 10-16) is labeled "Appellant failed to introduce substantial evidence of a contract of insurance, or the terms of insurance contract to be procured by appellee" (Br. 10). This heading fails to accurately embrace the theory of the case. Appellee continues on appeal to misunderstand (intentionally or unintentionally) appellant's theory of the case. As set forth in appellant's opening brief, appellant does not contend that appellee contracted to insure appellant; therefore, both alternatives in the appellee's "heading" are inapplicable.

Appellant does attach "a great deal of importance to the fact that there must be some arcane distinction between a contract of insurance and a contract to procure insurance" (Br. 10). The Oregon Supreme Court also attaches a great deal of importance to this "mysterious dictinction." To a reader of the recent Oregon decisions, there is no "secret" concerning the distinction.

Apparently appellee is not going to deign to recognize or comment upon the leading case of *Hamacher* v. *Tumy, et al,* 222 Or. 341, 352 P.2d 493 (1960), which is discussed at length in appellants' opening brief. *Hamacher, supra,* controls the determination of this appeal. In fact, appellee refuses to mention the recent case overruled by *Hamacher, supra.* [*Rodgers Insurance Agency* v. *Andersen Machinery,* 211 Or. 459, 316 P.2d 497 (1957)]. Perhaps the distinction which so confounds appellee would be less mysterious if twentieth century authorities were considered.

Appellee asks (Br. 12-13) the amount of coverage to be secured by Mr. Hill. It must be recalled that Mrs. Relos, the executrix of a decedent's estate (appellant's subrogor), was merely a laywoman and unschooled in the law and insurance coverages. Apparently Mr. Hill possessed some competence in insurance coverages since he secured the contract herein by representations concerning insurance protection. The rhetorical question poses a situation realistically treated in *Hamacher* v. *Tumy, supra.* The Oregon Supreme Court in *Hamacher, supra,* determined that when one seeks expert aid in securing coverage, the lay person is assumed to rely upon the expert to procure sufficient coverage under the circumstances. Possibly Mrs. Relos presumed that Mr. Hill would endorse the Postal Building upon the existing contracts of insurance which he had (or claimed he had). Mrs. Relos can hardly be faulted for not possessing expertise in the field of insurance.

Mrs. Relos, on behalf of appellant's subrogor, had

reason to be concerned about the operations of appellee because she testified that she did not have Workmen's Compensation coverage (Tr. 34). Appellee, through Mr. Hill, who had been long associated with the business, well knew what potential exposure could arise from window-cleaning operations.

Appellee seems to believe that a "wide open" risk was born by virtue of Mr. Hill's contract to procure insurance. His "glass on the barge in the Ganges" (Br. 10) example betrays a certain naivete. Appellant asserts (and the evidence shows) that appellee promised to procure insurance to protect its subrogor from liabilities arising out of the operations on the building by the appellee. Therefore, appellee's "parade of horribles" (Br. 10 et seq) is unworthy of comment.

Appellee misconceives the state of the evidence when he asserts:

> "There is not a scintilla of evidence that appellee ever agreed to procure insurance." (Br. 13)

Mrs. Relos testified that Mr. Hill represented that the Postal Building would be fully protected; if appellee did not, in fact, have the requisite insurance, then the evidence clearly supports a finding that appellee agreed to provide insurance for the protection of appellant's subrogor. If Mr. Hill's "puffing" meant that he was telling a falsehood when he claimed and warranted that he was fully insured for Mrs. Relos' protection, then it is appellant's contention that he agreed to procure the insurance he professed to have.

Throughout its brief (e.g. Br. 14) appellee contends

that it was not its "operations" that brought any insurance coverage into play; instead it is asserted that it was the appellant's subrogor's negligence that caused the Ramsey loss. This invalid assumption avoids the central issue in this case. Assuming, *arguendo,* that the appellant's subrogor was negligent, appellant contends that appellee contracted to procure insurance, and if his existing insurance did not cover his agreement, then he agreed to secure further insurance. If a person represents (as appellee admits that Mr. Hill did, Br. 15), that he was "fully insured for your protection," a lay person such as Mrs. Relos would normally assume that the Postal Building would be protected for those operations performed in and about the building by Mr. Hill and his employees.

Appellee claims (Br. 15) that Mr. Hill pointed out (after the fact) that he could not insure a third party for negligence on its part. This erroneous legal conclusion strictly avoids the vital issue. All insurance policies are indemnification agreements against carelessness or negligence on the part of the "indemnitee." Appellant contends that appellee contracted to procure sufficient insurance to protect appellant's subrogor during appellee's operations. Failure to do so breached the contract, and is the foundation of this lawsuit.

Appellee makes much of the fact that Mrs. Relos, on behalf of the Postal Building, had an existing public liability policy with appellant (Br. 15). Appellant's policy provided a different type of coverage than that promised by Mr. Hill; it would not prorate under the

Lamb-Weston theory (which is restricted to automobile coverages) and appellant's coverage was merely secondarily liable. Appellee's agreement here again indicates the curious confusion between indemnity agreements and agreements *to procure* insurance coverage. Moreover, Mrs. Relos testified that she was particularly concerned about the promised coverage because the Postal Building did not have Workmen's Compensation coverage (Tr. 34).

Appellee argues that the difference in cost between appellee's agreement and that charged by the prior window washer was attributable to the annual cleaning of Mrs. Relos' windows at home. There is no evidence to support this conclusion. Most likely the same agreement pertained as to the annual home window washing.

The conclusion of the fourth argument of appellee is incomprehensible, perhaps because appellant and appellee are considering different theories. This case is controlled by *Hamacher* v. *Tumy, supra,* which appellee refuses to recognize or discuss. Appellee agreed to procure insurance for the protection of appellant's subrogor; appellee breached this agreement and caused appellant's subrogor harm, for which recovery is sought.

5. The "indemnity" argument.

Instead of considering the theory upon which the case was tried, Argument 4, supra, appellee becomes needlessly perturbed and confused with problems emanating from indemnity agreements which indemnify an indemnitee for the consequences of his own negligence (Br. 16-20).

Appellant is not suing on a contract of indemnity. Appellant is suing on a breach of contract by appellee to procure insurance to protect appellant's subrogor from harm flowing from the appellees' operations in and about appellant's subrogor's building. Insurance always protects parties from the consequences of their own negligence. That is the purpose of insurance. An insurance policy is but a method of funding the consequences of one's own negligent acts; it is not a "hold harmless agreement" but rather is a fund to protect against potential liability and allocate losses. Appellant does not contend that appellee agreed to "hold appellant's subrogor harmless"; rather, appellee agreed to put at the disposal of the appellant's subrogor a fund to provide this limited protection. To argue that Mrs. Relos was barred because she did not use the words "hold harmless" (Br. 17) verges on sophistry.

Even assuming that discussion should be directed to indemnity agreements which indemnify for the consequences of one's own negligence, the governing recent Oregon authorities recognize that a party may be indemnified for the consequences of his own negligence. *Unitec Corporation* v. *Beatty Safway Scaffold Co.,* 358 F.2d 470 (9th Cir. 1966); *Southern Pacific Company* v. *Morrison-Knudsen Company,* 216 Or. 398, 338 P.2d 665 (1959); *Irish & Swartz Stores* v. *First National Bank of Eugene,* 220 Or. 362, 349 P.2d 814 (1960) (bailment).

Appellee would distinguish *Unitec Corporation, supra,* on the ground that the contract there considered in-

cluded an agreement to procure a policy of liability insurance (Br. 19). Appellant does not believe that this Court would have reached a different result in *Unitec Corporation, supra,* had the procurement of insurance clause been absent. 358 F.2d at 479. Why did the proposal submitted as a self-serving statement after the fact by Mr. Hill contain no customary hold harmless agreement? Obviously the insurance clause had been intended as a substitute for the hold harmless agreement.

Again assuming appellee's inaccurate major premise for sake of argument, is it reasonable to conclude in this case that the appellant's subrogor was solely negligent and solely caused Ramsey's injury? Appellant thinks not; it is likely that the Postal Building was not negligent at all and that the appellee's employee could have been protected by the use of jacks, by proper examination and inspection of the premises, and by general lookout for his own safety. The appellee held itself out as an expert in the field of window washing and should be bound by its "puffing" and asserted expertise.

A most interesting admission appears in appellee's brief:

> "All we have in this case is some 'puffing' by Mr. Hill that he had a full insurance program available. Indeed he had, * * *." (Br. 20)

Leaving aside any distinction between puffing and prevarication, apparently appellee admits that they had a full insurance program available that coincided with the "puffing" statement; if so, why was there allegedly no coverage for appellant's subrogor?

CONCLUSION

Appellant produced substantial evidence to require a jury determination upon the existence and terms of the contract to procure insurance in its favor by appellee. A factual controversy was presented which should have been passed upon by the triers of fact and should not have been removed from them by the direction of the verdict.

Appellee's three hurdles disappear when this case is considered in its proper perspective. Appellee's authority for its contention that appellant is not entitled to subrogation is inapposite. Appellee misunderstands appellant's theory of recovery and refuses to limit the discussion to *contracts to procure insurance*. The second and third "hurdles" become needlessly and hopelessly confused with talk in terms of "indemnity" and "hold harmless" agreements. Appellant contends that appellee contracted to procure a contract of insurance which would protect appellant from the consequences of the operations by appellee in and about the Postal Building. To this extent, an "indemnity agreement" was involved, since *insurance contracts always involve an "indemnity agreement" between insurer and insured*. Appellant was damaged by appellee's breach of this contract to procure and provide insurance, and appellee should respond in damages.

Respectfully submitted,

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James H. Bruce
Attorneys for Appellant
Maryland Casualty Company

CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those Rules.

JAMES H. BRUCE
Of Attorneys for Appellant

No. 21,019

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

E. R. FITZSIMMONS, Plaintiff and Appellant, vs. BRUCE W. GILPIN, Defendant and Appellee.	)

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF WASHINGTON,
SOUTHERN DIVISION

APPELLANT'S OPENING BRIEF

FILED

JUL 5 1966

WM. B. LUCK, CLERK

FITZSIMMONS AND PETRIS
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Oakland, California 9461

ATTORNEYS FOR APPELLANT

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While Ordinarily a Dismissal for Failure to Prosecute is With Prejudice Unless the Court Specifies Otherwise, the Dismissal Should Be Without Prejudice Where the Defendant's Actions Require Plaintiff to Take on Extraordinary and Additional Burdens in Order That the Disposition of the Action Might Be Expedited. 7

A Dismissal With Prejudice Constitutes an Abuse of Discretion Where the Court Moves to Dismiss Virtually Simultaneously With the Expiration of the Permissable Period of Inactivity Under Its Local Rules, Where the Delays Are at Least Partly Caused By the Defendant, and Where the Defendant is not Prejudiced By Plaintiff's Delay. 9

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JURISDICTION OF THE DISTRICT COURT

Jurisdiction of the District Court is founded on Title
, United States Code, Section 1331 (28 U.S.C. § 1331), in that
aintiff (hereafter referred to as "appellant") was at all requis-
e times a resident of the State of California, and defendant
ereafter "appellee") was at all such times a resident of the
stern District of the State of Washington.

JURISDICTION OF THE COURT OF APPEALS

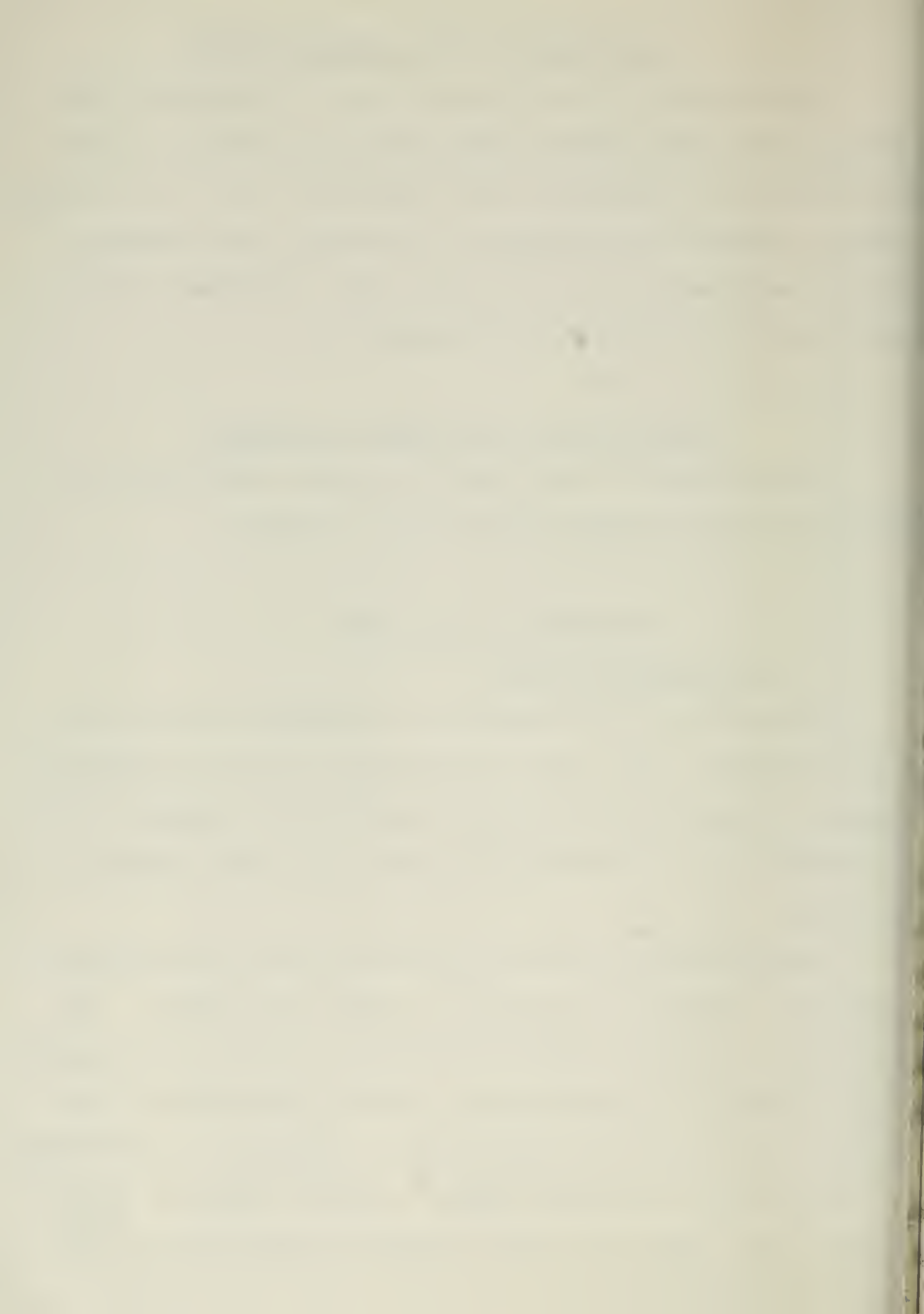
Jurisdiction of this Court is derived from Title 28,
ited States Code, Section 1291 (28 U.S.C. § 1291).

STATEMENT OF THE FACTS

A. The Lanphier Action.

The action is for payment of a promissory note, of the
lue of $13,000.00. The note was delivered to General Petroleum
rporation, a New York corporation (now Mobil Oil Company, a New
rk corporation) on or about May 21, 1956, and bears a date of
y 16, 1956.

Sometime prior to May 12, 1962, the note was assigned to
. Lanphier (hereafter "Lanphier") by Mobil Oil Company. Lan-
ier brought an action on the note on May 12, 1962 in the Superior
rt of the State of California for the City and County of San
ncisco. That action was entitled "H. N. LANPHIER vs. KWIK SHYNE
., a California corporation, BRUCE W. GILPIN, JAMES A. CAHILL"
several Does, Number 521,586, (hereafter referred to as "the
ginal Lanphier complaint.").



The original Lanphier complaint alleged that there was due and owing on the note the sum of $9,212.56. Under the , attached to the original Lanphier complaint, appellee Bruce ilpin (hereafter referred to as "Gilpin"), individually, and Shyne Ltd. (hereafter, "Kwik Shyne"), by Gilpin and James A. ll (hereafter, "Cahill") promised to pay the sum of $13,000.00 qual monthly instalments with interest, for one-hundred twenty hs, or until on or about May 16, 1966. The original Lanphier laint alleged that $9,212.56 was owing at the date of filing complaint. Kwik Shyne was served with the summons and original laint in the Lanphier action by service on the California etary of State.

Subsequently, the default of all defendants was entered, was later set aside by order of the court on November 28, 1962. mended complaint was filed January 25, 1963 and service of in and Cahill by publication was ordered on February 5, 1963.

Meanwhile, on January 30, 1963, Lanphier noticed the depo- on of Gilpin. On February 19, 1963, Gilpin obtained an order hing the notice, and ordering that the deposition not be taken. Shyne entered its Answer and Cross-Complaint to the amended hier complaint on or about March 1, 1963. Previously, Kwik e had received two extensions of time, totalling 30 days, in n to plead to the complaint.

On March 8, 1963, Gilpin and Cahill, purporting to r specially, received an order extending time to plead to mended Lanphier complaint to April 2, 1963.

On March 19, 1963, Lanphier filed her Answer to the oss-Complaint of Kwik Shyne. On April 2, 1963, the clerk of the perior Court issued a Notice of Trial Setting. Counsel for ik Shyne, by letter to the clerk, then requested that the ac- on be taken off the trial calendar.

Special appearances and motions to quash service of mmons on Gilpin and Cahill were set for April 9, 1963, but re continued by stipulation of counsel to April 24, 1963. On ril 25, 1963, the court ordered the summonses served on Gilpin d Cahill quashed.

On May 21, 1963, Lanphier noticed a motion for June 6, 53 (subsequently continued to June 20, 1963) for an order com- lling the attendance of Gilpin at a deposition to be held in kland, California. On or about June 28, 1963, counsel for fendants requested, and received, a continuance of the hearing that motion to July 5, 1963.

On July 5, 1963, Lanphier filed a Second Amended nplaint adding a second cause of action for fraud. An order owing the filing of that second amended complaint was granted July 11, 1963.

On July 11, 1963, the Superior Court ordered that the position of Gilpin be taken in Oakland, on condition that Lan- er pay the round trip air fare for Gilpin from Seattle-Tacoma San Francisco, plus $25.00 per day expenses. The date of the osition was set by agreement for August 1, 1963, and subse- ntly continued, also by agreement, to August 30, 1963.

On or about August 29, 1963, an amended order and stip-
tion permitting filing of the Second Amended Complaint was
ed, to supersede the prior order of July 11, 1963. On August
1963, the deposition of Gilpin was taken in Oakland, and Gil-
was served with the summons on the second amended complaint
that time.

On September 11, 1963, Kwik Shyne demurred and moved
strike the second amended complaint and the second cause of
ion thereof, and Gilpin moved to quash the above-mentioned
vice of summons. On October 23, 1963 the court ordered the
shing of the service on Gilpin which had occurred in Oakland
the previous August 30th.

B. <u>The FitzSimmons Action.</u>

Unable, after the passage of almost eighteen months
the filing of three complaints, to obtain jurisdiction of
pin, and convinced that Kwik Shyne had no assets to satisfy
judgment on the note, Lanphier assigned the note and cause
action to appellant herein. The present action was brought,
October 24, 1964, in the United States District Court for the
tern District of Washington, Northern Division. On December
1964, the appearance of Gilpin was entered by new attorneys.

On January 28, 1965, a dismissal without prejudice of
Lanphier action in the California Superior Court was entered.
r about December 29, 1964, Gilpin (hereafter referred to as
pin") moved to transfer the action from the Northern Division

the Western District of Washington to the Southern Division. the same time, appellee noticed motions to strike under Rule f the Local Rules of the Western District[1] (footnotes are in Appendix, infra), and to dismiss on the ground of another ion pending.

Apparently only the motion to transfer to the Southern ision was ever heard by the District Court, and an order was e on January 18, 1965 transferring the action. Appellee thereer did not renew his motions to strike and to dismiss.

On February 11, 1966, appellant was notified by the rk of the District Court that the court's motion to dismiss er its Local Rule 10[2] was set for March 7, 1966. Associated nsel appeared for appellant on that date. The Court, by minute er, ordered the action dismissed. This appeal followed.

ISSUES TO BE DECIDED

The issues before this Court are:

1. Was it an abuse of discretion for the District t to dismiss the action with prejudice?

2. Did the District Court abuse its discretion lismissing the action, with or without prejudice?

SPECIFICATIONS OF ERROR

Appellant contends that the District Court made the lowing errors:

1. The District Court abused its discretion in

issing the action with prejudice.

2. The District Court abused its discretion in issing the action, whether with or without prejudice.

ARGUMENT

Summary of Argument

The District Court's scope of permissable discretion he area of dismissals for failure to prosecute pursuant to l rules is gauged by the same rules as are applicable to 41(b) of the Federal Rules of Civil Procedure. Recent s have stressed that the rights of litigants are to be con- red foremost by the District Courts, and that the "public rest" of keeping dockets free from inertia is a consideration ndary in importance to those rights. The cases have empha- d the factor, inter alia, of prejudice to the other party, er than solely the convenience of courts, as a more crucial erion in determining whether failure to take action during quired period of time should result in dismissal. Appellant nds that the history of the litigation between the parties e present action does not dictate a result so disastrous to lant as the dismissal of his claim, and that, in any event, ourt abused its discretion in dismissing the action with dice.

Argument

I

WHILE ORDINARILY A DISMISSAL FOR FAILURE TO PROSECUTE
WITH PREJUDICE UNLESS THE COURT SPECIFIES OTHERWISE, THE
MISSAL SHOULD BE WITHOUT PREJUDICE WHERE THE DEFENDANT'S
IONS REQUIRE PLAINTIFF TO TAKE ON EXTRAORDINARY AND ADDITIONAL
DENS IN ORDER THAT THE DISPOSITION OF THE ACTION MIGHT BE
EDITED.

Appellant is forced to assume that the Court's dis-
sal was with prejudice, and that the dismissal would operate as
adjudication on the merits. Federal Rules of Civil Procedure,
e 41(b); American National Bank & Trust Co. of Chicago v.
ted States, (App. D.C. 1944) 142 F. 2d 571; Hicks v. Bekins
ing & Storage Co., (C.C.A. 9th, 1940), 115 F. 2d 406. Under
se circumstances, the District Court's action should be
utinized more closely than if the dismissal were without prej-
ce.

Costello v. United States, 365 U. S. 265, 81 S. Ct.
(1961), makes an important point with respect to the kinds
situations where policy dictates penalizing a plaintiff by
missing with prejudice. The issue before the Supreme Court
s whether a dismissal for failure of the plaintiff (the Govern-
n) to file an affidavit of good cause was a dismissal "for
of jurisdiction" under Rule 41(b) and thus without preju-
unless otherwise specified by the court. In holding in the
rmative on that issue, the Court spoke of the several classes
ituations under Rule 41(b) where the dismissal, unless
rwise specified, was with prejudice, including motions to

smiss for failure to prosecute:

> "All of [these kinds of dismissals with prejudice] enumerated in Rule 41(b)...primarily involve situations in which the defendant must meet the merits because there is no initial bar to the court's reaching them. It is therefore logical that a dismissal on one of these grounds should, unless the court specifies otherwise, bar a subsequent action. ... Although a sua sponte dismissal is not an enumerated ground, here too the defendant has been put to the trouble of preparing his defense because there was no initial bar to the court's reaching the merits." 365 U.S. 265, 286, 81 S. Ct. 534, 545.

In the present case, what appellant's "failure" in
:t amounted to was nothing more than his failure to request
:ry of default and default judgment, prior to appellee's notice
motions to transfer, strike and dismiss, on December 29, 1964.
:er these motions were noticed, but not heard, appellee, having
hnically satisfied the necessity of entering a responsive
ading, but without actually doing so, sat back and did nothing,
avoided the necessity of having to meet the merits. What oc-
red here is not the situation described in the Costello case,
ra, i. e., the situation where the plaintiff failed to do the
ngs that only he is in a position to do to bring the action
trial. It seems clear that a dismissal with prejudice should
ult only in those situations where there is nothing left for the
endant to do in order that the action might proceed to the next
ge, and the plaintiff fails to take the steps that, in the
inary course of litigation, are his responsibility. In the
sent case, appellee effectively placed a double burden on appel-

it. Appellant could not move toward bringing the case to trial fore appellee had entered a responsive pleading. Nor could pellant, after December 29, 1964, attempt to secure a default lgment. The only course available to him after that date was move for a summary judgment. But this would have placed on him th rden of a court appearance, at a distance of more than a usand miles from appellant's residence, merely to force appel- to enter a full defense, which in the ordinary course of liti- ion should have been within twenty days after service of the mons. Appellant's chances of obtaining a summary judgment at t stage were slim at best, since the court was most likely to use the summary judgment and merely require appellee to enter responsive pleading within a prescribed time. That possibility not trouble appellee, since eventually he would be required answer in any event, unless the action were dismissed by ap- lant voluntarily. So appellee did just enough to avoid a ault, and in refusing to do more, placed an added, and unjusti- d burden on appellant to move to force appellee to defend the im. Appellant contends that because of this added burden, ced on him not merely as a result of his own recalcitrance, but gely by that of appellee, it was an abuse of discretion for court to dismiss the action with prejudice.

II

A DISMISSAL WITH PREJUDICE CONSTITUTES AN ABUSE OF CRETION WHERE THE COURT MOVES TO DISMISS VIRTUALLY SIMUL- EOUSLY WITH THE EXPIRATION OF THE PERMISSIBLE PERIOD OF CTIVITY UNDER ITS LOCAL RULES, WHERE THE DELAYS ARE AT LEAST LY CAUSED BY THE DEFENDANT, AND WHERE DEFENDANT IS NOT PREJ-

The appellate cases concerned with dismissals for lure to prosecute seem largely to have been decided on the ticular circumstances presented in each case. See Link v. ash R. Co., 370 U.S. 626, 82 S. Ct. 1386 (1962); Sandee Mfg. v. Rohm & Haas Co., (C.A. Ill., 1962) 298 F. 2d 41. The im- tant factors seem to be:

(a) The length of time elapsing between the end of allowable period of inactivity under the local rule, and the rt's motion to dismiss the action;

(b) Whether the plaintiff was clearly dilatory shown by attempts by plaintiff to impede the progress of the igation;

(c) Whether or not the party benefitting from a nissal was himself prompt in pursuing the methods of disposi- available to him; and

(d) The amount of ultimate prejudice to such y.

In Sykes v. United States (C.A. 9, 1961) 290 F. 2d 555, action had been inactive for twenty-eight days beyond the local 's permissable period of of inactivity--six months, when the n to dismiss was made. This Court held that the trial court abused its discretion in dismissing for want of prosecution, e reserving the right of the lower court to reconsider the on to dismiss if the defendant could show prejudice. In the ent case, the trial court noticed its motion to dismiss on uary 11, 1966, one year and twenty-four days after the action been transferred to it. While it is true that the action had

teen months previously, the action had been delayed approximately ee weeks, between December 29, 1964 and January 25, 1965, as esult of appellee's motion to transfer from the Northern Divon of the District, to the Southern Division.

That appelee has not been prejudiced by any delay in secuting the action is clear. On the contrary, he has reved nothing but benefit from appellant's inactivity, which ctivity has contained a large measure of leniency with respect requiring appellee to plead a defense. While the action was ed on October 27, 1964, appelee failed to file any responsive ading until December 29, 1964. Even then, appelee delayed an itional twenty days after noticing his motions to transfer, ike and dismiss, before bringing the first mentioned motion to earing. Then, apparently satisfied with his success in transring the action to the Southern Division, he never brought on hearing his motions to dismiss and to strike, and never filed esponsive pleading of any kind thereafter. After a successful ble that appellant would not take his default without some or notice, and later, when he had avoided that possibility hout having to answer, unwilling to bring the litigation to stage where it would at least be at issue, he now seeks to it from the work that the District Court has done for him.

This tactical maneuvering on the part of the appellee, ising the inconvenience of an appearance in Washington by the llant to avoid the necessity of having to answer the claim,

d have required appellant to take additional steps, beyond usual burden placed upon him as a plaintiff to move the gation to a conclusion. Appellee's actions are tantamount elibertate delay by him. Where there is delay by both parties, where no prejudice results to the defendant from plaintiff's y, the court should not dismiss the action. Wholesale Supply v. South Chester Tube Co., (E.D. Pa., 1957), 20 F.R.D. 310; oro Co. v. Fisher & Porter Co.,(D.C. Pa., 1961), 29 F.R.D.

A dismissal where the plaintiff was not alone at fault is buse of discretion. Carnegie National Bank v. City of Wolf t (C.C.A. 9, 1940), 111 F. 2d 569; see also International Harer Co. v. Rockwell Spring & Axle Co., (C.A. Ill., 1964) 339 d 949 (defendant's failure to answer complaint, inter alia, dismissal unjustified).

"Dismissal is a harsh sanction and should be resorted nly in extreme cases." Meeker v. Rizley, (C.A. 10, 1963) 324 d 269. In Alamance Industries, Inc. v. Filene's, (C.A. 1, 1961) F. 2d 142, cert. den. 368 U.S. 831, 82 S. Ct. 53 (1961), the t commented:

> "Apparently what principally lay behind the district court's determination to try the case is to be found in its remark made at the first hearing, that the 'public interest' in not having a case lie on its docket for fourteen months must control 'regardless of the interest of the parties.' We cannot accept that statement either as the formulation of a generally applicable principle or as a proper criterion for the disposition of this particular case. Courts exist to serve the parties, and not to serve themselves, or to present a record with respect to dispatch of business. Complaints heard as to the law's delays arise because the delay has injured the litigants, not the courts.

For the court to consider expedition for its own sake 'regardless' of the litigants is to emphasize secondary conseiderations over primary." 291 F. 2d 142, 145.

In summary, appellant contends that his rights have been regarded in the District Court's zeal to keep a 'clean' endar. The history of the litigation between the parties eto, beginning with the Lanphier action, is not one of connt and continuing delays by appellant. The California state rt action failed to be concluded only because of appellee's cessful evasion of that court's jurisdiction. Appellant, n pursuing the claim in a forum that gave no justification any claim of inconvenience to appellee, but instead, placed urden of distance on appellant, was frustrated by a different tic to avoid the claim: for instead of meeting appellant's m on the merits, appellee sought to, and did, use to his antage the fact that it would be burdensome for appellant ave to appear in the Washington District Court. Appellee efore attempted to force the necessity for such an appear- by noticing what would have been responsive pleadings, pt for the fact that appellee never brought them on for a ing. While the burden is properly on the plaintiff to ecute the action to a conclusion, that burden should not be d to by the evasiveness of the defendant in meeting his en of answering the claim, particularly when the result of ing to meet such additional burden is dismissal with prejudice.

In view of the foregoing circumstances, not only was it abuse of discretion for the trial court to dismiss with pre-dice, but for the court to dismiss at all, since defendant nefitted from the delay, the court's local rule had been violated ly by a matter of less than one month, and the delay had been used at least partly by the actions of appellee.

Appellant urges that the judgment of dismissal be versed.

ted: July 5, 1966.

Respectfully submitted,

FITZSIMMONS AND PETRIS

By____________________________
Anthony W. Hawthorne

Attorneys for Plaintiff and
Appellant Edward R. FitzSimmons

APPENDIX

.. Rule 5 of the General Rules, United States District Court for the Western District of Washington, is now General Rule 2(d):

> "Any member in good standing of the bar of any court of the United States, or of the highest court of any other state, or of any organized territory of the United States, may be permitted upon application to appear and participate in a particular case if there shall be joined of record in such appearance an associate attorney having an office in this District and admitted to practice in this Court who shall sign all pleadings prior to filing and otherwise comply with Rule 4(a) hereof."

. Rule 10 of the Civil Rules, United States District Court for the Western District of Washington, is as follows:

> "All cases that have been pending in this Court for more than one year without any proceeding of record having been taken may be dismissed by the Court on its own motion for want of prosecution."

CERTIFICATION

I, Anthony W. Hawthorne, certify that in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Anthony W. Hawthorne

No. 21,019

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

E. R. FITZSIMMONS,	)
	)
Plaintiff and Appellant,	)
	)
vs.	)
	)
BRUCE W. GILPIN,	)
	)
Defendant and Appellee.	)

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF WASHINGTON,
SOUTHERN DIVISION

APPELLEE'S ANSWERING BRIEF

FILED
AUG 4 1966
WM. B. LUCK, CLERK

GAGLIARDI & GAGLIARDI
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Tacoma, Washington 98402

ATTORNEYS FOR APPELLEE

NOV 4 1966

No. 21,019

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

E. R. FITZSIMMONS,)
)
Plaintiff and Appellant,)
)
vs.)
)
BRUCE W. GILPIN,)
)
Defendant and Appellee.)
)

APPEAL FROM THE UNITED STATES DISTRICT COURT
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APPELLEE'S ANSWERING BRIEF

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JURISDICTION OF THE DISTRICT COURT

Jurisdiction of the District Court is founded on Title
8, United States Code, Section 1331 (28 U.S.C. § 1331), in that
laintiff (hereafter referred to as "appellant") was at all requisite
imes a resident of the State of California, and defendant (hereafter
appellee") was at all such times a resident of the Western District
f the State of Washington.

JURISDICTION OF THE COURT OF APPEALS

Jurisdiction of this Court is derived from Title 28, United States
ode, Section 1291 (28 U.S.C. § 1291).

STATEMENT OF THE CASE

This action is based on a promissory note which was executed on ›r about May 16, 1956. The complaint in this action was signed on ugust 24, 1964, and filed in the United States District Court for the Vestern District of Washington, Northern Division, on October 27, 1964, nd served on the defendant, BRUCE GILPIN, on November 16, 1964.)n December 4, 1964, your author filed a duplicate original Notice of ppearance with the Clerk of the District Court in Seattle, Washington.)n same day, a letter was written to Fitzsimmons and Petris, attorneys or the plaintiff, enclosing the original and one copy of the Notice of ppearance, and requesting them to acknowledge service on the original nd return it to my office for filing. This letter was never answered, nor as the Notice of Appearance ever returned.

On December 29, 1964, your author filed a motion asking for lternative relief.

(1) To transfer the action to the Southern Division based on the esidence of the defendant.

(2) To dismiss the action on the grounds that another action was ending on the same subject matter.

(3) To strike all pleadings of the plaintiff for his failure to associate esident counsel within ten days of the filing of the suit as required by Local ule 5[1] (footnotes in appendix) of the District Court for the Western District f Washington.

On this same day, December 29, 1964, I wrote to Fitzsimmons and Petris, noticing this motion for January 11, 1965. This motion was heard on January 18, 1965 and even though no one appeared on behalf of the plaintiff, the Court granted only the motion to transfer the action to the Southern Division, but without prejudice to the defendant's motion to strike the pleadings and to dismiss the action, giving the plaintiff additional time in which to comply with Local Rule 5[1]. On March 1, 1965, he Clerk of the District Court advised Fitzsimmons and Petris of the action of the Court. Again nothing was ever heard from them.

On February 10, 1966, fifteen and one-half months after the complaint had been filed, the Clerk of the District Court, Southern Division, advised all parties that the cause was to be placed on the court calendar for March 7, 966, under Local Rule 10[2] for dismissal for want of prosecution. On March 4, 1966, Conrad, Kane and Vandeburg filed their notice of association s local counsel in the action. On March 7, 1966, the motion to dismiss was argued by both sides, the Court listened to the arguments, examined he affidavit of the plaintiff, E. R. Fitzsimmons, found that no good cause r adequate explanation for the delay existed, and dismissed the action by minute order. This appeal followed.

ISSUE TO BE DECIDED

The only issue before this Court is: Was it an abuse of discretion or the District Court to dismiss the action on its own motion?

ARGUMENT

The District Court's authority to dismiss a case where the plaintiff as failed to prosecute the action with reasonable diligence is found in ule 41(b) of the Federal Rules of Civil Procedure, and Rule 10[2] of the ivil Rules of United States District Court for the Western District of ashington, and is also an inherent power of the said Court. In Shotkin v. estinghouse Electric and Manufacturing Company, (C. A. Colo., 1948) 59 F. 2d 825, 826, the Court said:

> "A District Court of the United States is vested with power to dismiss an action for failure of the plaintiff to prosecute it with reasonable diligence. The power is inherent and independent of any statute or rule. And where plaintiff has failed to prosecute the action with reasonable diligence, Court may dismiss it on motion of the defendant or on its own motion......"

The appellant in his brief has attempted to bring before this Court cts outside the record, by what he refers to as the "Lanphier Action." nis is not only undesirable, but is not authorized. See Russell v. unningham, (C. C.A. 9, 1956) 233 F. 2d 806, 809, where the Court said:

> "Both parties in their brief seek to bring before this Court facts outside the record made below, but such an attempt to enlarge the record must be rejected..."

The only facts material to decide the issue in this case are the facts ntained in the record. An examination of that record reveals the total sregard by appellant of the rules of not only the United States District urt, but also of this Honorable Court -- specifically (Tr.1) letter from strict Court Clerk to Fitzsimmons and Petris requesting cost bond of non-

esidents dated 9/2/64; (Tr. 2) letter from District Court Clerk to Fitzsimmons nd Petris advising non-resident cost bond not yet received dated 10/5/64; Tr. 3) letter from District Court Clerk to Fitzsimmons and Petris returning omplaint for failure to file non-resident cost bond dated 10/16/64; (Tr. 106) etter from Circuit Court of Appeals Clerk to Fitzsimmons and Petris dvising record on appeal not transmitted if designation of record not iled dated 4/25/66.

To further demonstrate the lack of interest the appellant had in rosecuting his lawsuit, I refer to the motion to set aside order of dismissal, ith affidavits of Yancey Reser and William D. Gowans, and especially he affidavit of James K. Moore (which are Tr. 65, 77 and 83).

I quote from the affidavit of James K. Moore on the second page:

> "On January 20, 1964, I wrote a letter to Mr. Fitzsimmons copy of which is attached as Exhibit A. I received no answer to this letter.
>
> On February 18, 1964, I received a verbal report of the status of the account through Mr. R. H. Buchanan, one of the corporation attorneys for Sony-Mobil Oil Company, Inc., stating that Mr. Fitzsimmons expects to get a judgment and full recovery within six months.
>
> On September 21, 1964, I wrote a letter to Mr. Fitzsimmons, a copy of which is attached as Exhibit B. I received no answer to this letter.
>
> On October 27, 1964, I sent a tracer to Mr. Fitzsimmons, a copy of which is attached as Exhibit C. I received no answer to this tracer.
>
> On November 11, 1964, I again wrote to Mr. Fitzsimmons, a copy of which letter is attached as Exhibit D. I received no answer to this letter.

On November 30, 1964, I telegraphed to Mr. Fitzsimmons a copy of which telegram is attached as Exhibit E. I received a letter from Mr. Fitzsimmons' secretary dated November 30, 1964, a copy of which is attached as Exhibit F, stating in effect that Mr. Fitzsimmons was out of the country.

On March 17, 1965, I wrote a tracer to Mr. Fitzsimmons, a copy of which is attached as Exhibit G. I received no answer to this tracer.

On March 31, 1965, I sent a certified mail letter to Mr. Fitzsimmons, a copy of which is attached as Exhibit H. Again I received no answer.

On July 27, 1965, I telephoned Mr. Fitzsimmons at his office in Oakland, and he informed me that the documents were in the Court in the State of Washington and promised to send us a full report.

To the date of this affidavit, I have never received any reports from Mr. Fitzsimmons as to the status of the case, and have no personal knowledge of the status of any lawsuits instituted by Mr. Fitzsimmons in regard to this matter.

Some date prior to December 8, 1965, I consulted with our house counsel, Mr. William D. Gowans, regarding the matter of determining the status of the collection suit or suits filed by Mr. Fitzsimmons, after which I left the matter and files in the hands of Mr. Gowans for his further checking. I know that Mr. Gowans wrote Mr. Fitzsimmons on December 9, 1965, but has never received from Mr. Fitzsimmons any written reply or report on the status of any lawsuits filed by Mr. Fitzsimmons.

The above is true and correct to the best of my knowledge and recollection.

(Signed) James K. Moore."

This case is clearly not one of ordinary neglect on the part of the appellant to prosecute the action in the District Court, but is one of gross

ouse at every stage of the proceedings. The note itself, which was the
ubject matter of the action in the lower Court, is itself over ten years
d and the subject of prior litigation. In this regard, see Salmon v. City
Stuart, Florida, (C.A. Fla. 1952) 194 F. 2d 1004, where the Court said:

> "When it comes to the merits though, we think it plain that the order should be affirmed. Putting to one side that what is being litigated here is old straw which has been thrice threshed, or sought to be threshed, in the Courts, it stands undisputed that, following the filing of this the third suit, no action was taken by the plaintiffs for one year and three months. Matters standing thus, the Court was fully authorized to dismiss the action. The Order of Dismissal is affirmed...."

The appellant further in his brief suggests that the burden to push the
atter to a final determination somehow rests upon the defendant. This is
t only a preposterous proposition, but in addition, the record discloses
d the defendant renoted this motion to strike the plaintiff's pleadings,
e said motion would almost certainly have been granted. For although
otion was filed December 29, 1964 under Local Rule 5[1] of the United
ates District Court for the Western District of Washington, the plaintiff
d not associate local counsel until March 4, 1966, which is a period of
tter than fourteen months, and in addition, is almost a month from
e date that the Clerk of the District Court wrote to the plaintiff advising
at the cause was to be placed on the Court calendar on March 7 for
smissal under local Rule 10[2] (Tr. 32). In this regard, see Hicks v.
kins Moving and Storage Co., et al, (C.C.A. 9, 1940) 115 F. 2d 406,
409, when this Court said:

"This power to dismiss for want of prosecution may be exercised by the Court on its own motion though no action to secure such result be taken by the defendant. (citing cases) Moreover, an order of dismissal may be granted, notwithstanding the plaintiff has been stirred into action by the intending dismissal, for subsequent diligence is no excuse for past negligence. (citing cases)

The duty rests upon the plaintiff at every stage of the proceeding to use diligence to expedite his case to a final determination, and unless it is made to appear that there has been a gross abuse of discretion on the part of the trial court in dismissing the action for lack of prosecution, its decision will not be disturbed on appeal......."

Appellant further complains that the fact that he brought the action i the United States District Court for the Western District of Washington, vhich was obviously the proper forum under the circumstances) placed a ırden of distance on the appellant, and that the appellee's motion was ome kind of frustrating tactic to put an additional burden on appellant) appear in the Washington District Court. This argument overlooks ree significant facts:

(1) The appellant chose the forum in which to proceed and

(2) Had appellant complied with Local Rule 5[1] and associated cal counsel, he would not have only avoided the necessity of traveling to e Washington District Court, but would have provided a local representa- e that appellee could serve papers on and otherwise communicate with.

(3) That the District Court, and not the appellee, made the motion to dismiss for failure to prosecute.

The appellant further charges the appellee with delay. This is not true, and the record so discloses. The Summons and Complaint were served on November 16, 1964 (Tr. 13). Appellant was retained on December 4, 1964, and filed his Notice of Appearance on that date (Tr. 14). On December 29, 1964, he filed a Motion to Transfer, Strike and Dismiss. This motion was noticed immediately and was called for hearing on the first available motion day, which was January 11, 1965. This motion was continued by the Clerk until January 18, 1965, at which time it was heard, as previously set forth. The Honorable Judge Beeks of the District Court granted the Motion to Transfer, and continued the Motion to Strike and Dismiss in an act of indulgence toward the appellant. Had the appellant at this juncture complied with the rules -- that is to say, appointed a local representative as required under Local Rule 5[1] who would have advised appellee that the action pending in California had been dismissed, the motion would have then been academic, and appellant would have been in a position to demand an answer and note the matter down for trial. In this regard, no request, demand or otherwise has ever been made of appellee to answer or note the motion. As a matter of fact, the only letter that has been received by the appellee from the appellant's attorney to date was received on June 24, 1966.

There isn't any question, and the record in this case clearly emonstrates that the appellant was not only guilty of gross negligence, nd without an adequate explanation for the delay, but is also guilty of total disregard of the Federal Rules of Civil Procedure, as well as e Local Rules of the United States District Court, and that the appellant ad to be prejudiced by the long delay. In this regard, see William R. ussell v. William Cunningham, Supra, at page 810:

> "The facts supported by the record are that the case had been pending for fifteen months with little action on the part of the appellant to bring it to trial, and two continuances had been granted. ******Appellant argues that on the facts supported by the evidence in the record it was a 'gross abuse of discretion' to deny a continuance or a dismissal without prejudice. **** However, defendants should not be kept with lawsuits hanging over their heads for long periods of time as litigation expenses mount. (Emphasis supplied.) The Courts also have an obligation to other litigants to keep their calendars clear as was pointed out in Boling v. United States, (C.C.A. 9) 231 F. 2d 926, 927. 'One of the causes of the congestion of the trial dockets is the failure of the courts to exercise the authority vested in them, thus to dispose of cases which are shaky or unfounded, but which are held on the calendar for nuisance value. Since trial judges are hesitant to dismiss such causes of their own motion, for fear of injustice to some litigant, the device of placing cases in which no action has been taken for a considerable time on a docket for dismissal, absent a showing of adequate explanation for delay, has been used. But even this palliative for the admitted evil has been of little avail, because of the innate hesitancy mentioned above. Because of this fact, an order of dismissal for failure to prosecute will never be set aside unless there has been an abuse of discretion and, of course, such a situation is never presumed.'

continuances and no sign that the appellant was any nearer to trial in August of 1955 than he was in April of that year or in June of the previous year at the time of the pre-trial order. While the case involves nowhere near the abuses found in the typical situation where F.R.C.P. 41(b) is invoked it cannot be said that the District Court abused its discretion without resorting to contentions of fact not found in the record......"

In summary, the burden rests upon the plaintiff at every stage of the proceedings to prosecute his action with diligence. Upon his failure to do so, under the Federal Rules of Civil Procedure, the Local Rules and the inherent powers of the District Court, his case may be dismissed, and unless he can show good cause or has an adequate explanation for the delay, the Court is within its authority in dismissing the same. In this case, not only do we have a considerable length of time -- fifteen and a half months -- but we have total inaction on the part of the appellant with absolutely no excuse whatsoever on the part of the appellant, except perhaps the affidavit of Edward R. Fitzsimmons. (See Tr. 37 and 41.) In light of the foregoing, it must be presumed that the appellee was prejudiced by the actions of the appellant and that the lower Court did not abuse its discretion in dismissing the action. See Link v. Wabash, 291 F. 2d 542, Affirmed 370 U. S. 626, 8 L. Ed. 2d 734:

> "Courts may exercise their inherent powers and invoke dismissal as a sanction in situations involving disregard by parties of orders, rules or settings...."

Appellee urges that the judgment of dismissal be affirmed.

Dated: July 26, 1963

Respectfully submitted,

GAGLIARDI & GAGLIARDI

By [signature]

APPENDIX

Rule 5 of the General Rules, United States District Court for the

estern District of Washington:

> "If a party in any civil cause does not appear in proper person, and if the attorney appearing for such party does not maintain an office within this State, there shall be joined of record in such appearance, within ten (10) days thereafter, an associate attorney having an office in this District and admitted to practice in this Court; in default of which, all pleadings filed in behalf of such party may be stricken out by the Court, either upon motion or it's own initiative. The appearance of such associate attorney shall state his office address in this State and service of all papers at such office shall have the same effect as if such office address were that of the attorney originally appearing."

le 5 of the General Rules is now General Rule 2(d).

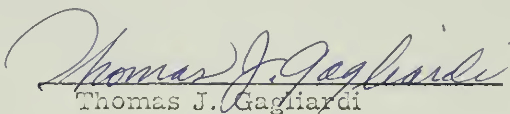
Rule 10 of the Civil Rules, United States District Court for the

stern District of Washington, is as follows:

> "All cases that have been pending in this Court for more than one year without any proceeding of record having been taken may be dismissed by the Court on its own motion for want of prosecution."

CERTIFICATION

I, Thomas J. Gagliardi, certify that in connection with the
ration of this brief, I have examined Rules 18 and 19 of the
ed States Court of Appeals for the Ninth Circuit, and that, in
opinion, the foregoing brief is in full compliance with those rules.



Thomas J. Gagliardi

No. 21,019

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

R. FITZSIMMONS,)
Plaintiff and Appellant,)
.)
UCE W. GILPIN,)
Defendant and Appellee.)

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF WASHINGTON,
SOUTHERN DIVISION

APPELLANT'S REPLY BRIEF

FILED

SEP 22 1966

WM. B. LUC[illegible] CLERK

NOV 4 1966

FITZSIMMONS AND PETRIS
405 Fourteenth Street
Oakland, California 94612

ATTORNEYS FOR APPELLANT

'No. 21,019

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

. R. FITZSIMMONS,)
Plaintiff and Appellant,)
s.)
RUCE W. GILPIN,)
Defendant and Appellee.)

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF WASHINGTON,
SOUTHERN DIVISION

APPELLANT'S REPLY BRIEF

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ARGUMENT

Appellee complains of appellant's recital of the istody of the litigation on the note that is the subject of iis action, and then goes on in his Answering Brief to cite orrespondence from this Court to Appellant concerning admini-rative matters in the perfecting of this appeal, and 'fidavits of a person not a party to this appeal (Appellee's iswering Brief, pp. 3-5). While these matters may technically part of the record on appeal, they are immaterial to the sues on this appeal, and could only have been inserted by pellee's counsel for the purpose of prejudicing Appellant fore this Court. The only issues in this appeal are:) Whether the District Court abused its discretion in smissing this action with prejudice; and (2) Whether that urt abused its discretion in dismissing the action, with without prejudice.

It is true, as Appellee's brief notes (p. 6), that e note that is the subject of the present action has been the bject of prior actions. But it is not true that the merits ve been "threshed" in other courts. As shown in Appellant's ening Brief, the history of the litigation on this note is e of plaintiff's long and arduous pursuit of a judgment, ustrated by Appellee's all too successful evasive tactics.

As also noted in Appellant's Opening Brief, the recent

ses concerned with dismissals for want of prosecution have ated the requirement of finding prejudice to the defendant d absence of stalling tactics on his part. (See cases cited Appellant's Opening Brief, page 12.) The statement in pellee's Brief (p. 10) that "it must be presumed that appellee s prejudiced by the actions of the appellant" is wholly thout substantiation either as a rule of law or as a factual nclusion. The issue of prejudice was not discussed in Link v. bash, 291 F. 2d 542 (1961), affirmed 370 U.S. 626, 8 L. Ed. 2d 4, cited by Appellee as authority for this "presumption" ppellee's Brief, p. 10). On the contrary, the facts here ow nothing in the way of prejudice to Appellee. Appellee uld have avoided having a lawsuit hanging over his head for long period by entering a defense on the merits either in e Lanphier action, or at any time in this action. If the tion on the note is meritorious, then indeed there would be ejudice to Appellee; but it is inconceivable that where pellee contrives to avoid determination on the merits by fusing even to file a defensive pleading he is "prejudiced" Appellant's failure to force such a response.

This is clearly an instance where the defendant, s well as the plaintiff, has been responsible for the delay n prosecution of the action. Thus, under the cases cited at ae 12 of Appellant's Opening Brief, the present case is one n which dismissal by the District Court constituted an abuse f its discretion, and the judgment of dismissal should be

eversed.

DATED: September 21, 1966.

Respectfully submitted,

FITZSIMMONS AND PETRIS

By Anthony W. Hawthorne
Anthony W. Hawthorne

Attorneys for Plaintiff and
Appellant EDWARD R. FITZSIMMONS

CERTIFICATION

I, ANTHONY W. HAWTHORNE, certify that in connec-
on with the preparation of this brief, I have examined
les 18 and 19 of the United States Court of Appeals for
e Ninth Circuit, and that, in my opinion, the foregoing
ief is in full compliance with those rules.

Anthony W. Hawthorne

No. 21037

IN THE

United States Court of Appeals For the Ninth Circuit

University Properties, Inc.
Petitioner,

v.

Commissioner of Internal Revenue,
Respondent.

PETITION TO REVIEW A DECISION OF THE TAX COURT OF THE UNITED STATES

OPENING BRIEF OF PETITIONER

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IN THE

United States Court of Appeals
For the Ninth Circuit

No. 21037

University Properties, Inc.
Petitioner,

v.

Commissioner of Internal Revenue,
Respondent.

PETITION TO REVIEW A DECISION OF THE TAX COURT OF THE UNITED STATES

OPENING BRIEF OF PETITIONER

Jurisdictional Statement

This action was commenced by the petitioner, University Properties, Inc., against the respondent, the Commissioner of Internal Revenue, in the Tax Court of the United States upon a petition for redetermination of asserted deficiencies of $40,114.29 and $38,573.53 in petitioner's income taxes for its fiscal years ended October 31, 1961 and October 31, 1962, respectively. (R-1-11)

Following a decision and order by the Tax Court affirming the said deficiencies, (R-38) a petition for review thereof by the Ninth Circuit was filed. (R-39-42)

The following citation contains reference to the statutory authority believed by petitioner to sustain the initial jurisdiction of the Tax Court and the jurisdiction to review by this court:

"This is a petition for review or a Tax Court decision sustaining the Commissioner's determination of deficiency in income taxes of the petitioner . . . Both the Tax Court and this court have jurisdiction. 26 U.S.C. (IRC, 1939) §1141(a); (IRC, 1954) §7482(a)."

Holtz v. Commissioner of Internal Revenue, 268 F.2d 865, 866, 867 (9th Cir., 1958).

STATEMENT OF THE CASE AND QUESTIONS PRESENTED

General Background

Respondent determined deficiencies in petitioner's income taxes for its fiscal years ended October 31, 1961 and October 31, 1962 in the respective amounts of $40,-114.29 and $38,573.53. These asserted deficiencies resulted from the disallowance by the respondent of certain $80,000 payments made by petitioner to its lessor, the University of Washington, pursuant to a supplemental lease agreement dated February 5, 1958 wherein such payments were referred to as "additional rentals." (Jt. Ex. 4-D)

Petitioner contends that the said payments were current rents or, alternatively, ordinary and necessary business expenses and deductible in full for the years in which paid. The respondent contends that said payments were capital expenditures for the acquisition of certain property added to petitioner's leasehold by the said supplemental lease agreement, or were advance rentals, to be deducted ratably over the remaining term of the lease.

Petitioner, a private corporation, was incorporated under the laws of the state of Delaware on July 6, 1953.

Its principal offices are located in Seattle, Washington. (R-19) Petitioner's income tax returns for the years here in question were filed with the District Director of Internal Revenue, Tacoma, Washington. (R-19) Copies of said returns appear as Joint Exhibits 2-A and 2-B.

The Original Lease

On July 18, 1953, petitioner entered into a lease agreement with the University of Washington, lessor, demising a portion of a tract located in the heart of downtown Seattle to petitioner for a term of 35 years from November 1, 1954. (R-21; Jt. Ex. 3-C) Said lease provided for fixed rents to be paid for the lease years commencing November 1, 1954, November 1, 1955, November 1, 1956 and November 1, 1957 of $1,600,000, $1,700,000, $1,700,000, and $1,800,000, respectively. Thereafter, for each succeeding fiscal year a percentage rent was to be paid by petitioner on the total gross rental income from the demised premises. This amount had reference to the gross rental income collected by petitioner from tenants in the operation of the premises. (R-21)

Under the said percentage rental provisions, a minimum guaranteed rent of $1,000,000 per year was reserved. This minimum rental was subject to abatement in the event that, for any reason other than the default of the lessee, any portion of the demised premises should not be capable of being occupied, operated or used by the lessee. In such event, the minimum rent was to be reduced for the period of time such space remained untenantable in the amount which would have been lessor's percentage rental for the untenantable space, if such space

had been tenantable. (Ex. 3-C, pp. 7, 8)

Petitioner was obligated by said lease to operate the various structures and buildings then or thereafter constructed on the demised premises in such a manner as not to injure the reputation thereof and to maintain the demised premises and area as a center of store and office buildings of the first class in the city of Seattle. (Ex. 3-C, p. 8)

The original lease also contained a provision for a new building fund under which the lessee agreed to study from time to time the desirability and economic necessity for the construction of new buildings and capital alterations and to make recommendations to the lessor with reference thereto. The lessor had the right to determine what buildings and capital improvements would be made and the lessee would be responsible for the construction of such buildings and improvements with the right to be reimbursed from the new building fund for the cost thereof. (Ex. 3-C, p. 16)

The Post Office Tract Acquisition

On January 29, 1958 petitioner's lessor acquired from the United States, a parcel of land some 4,400 sq. ft. in area which formerly comprised a part of a United States Post Office site. This 4,400 sq. ft. parcel, hereinafter referred to as the Post Office tract, abutted the premises demised under the lease of July 18, 1953 to petitioner. As consideration for the Post Office tract, petitioner's lessor agreed to demolish the old Post Office Building and to construct a new Post Office Building on the part of the site retained by the Federal government. (R-21, 22)

The Douglas Building, smallest and least profitable of the buildings located on the premises demised under the original lease occupied the site adjacent to the Post Office tract. It was decided by the University of Washington and petitioner that the Douglas Building would be demolished and a new building, to be known as the Washington Building, would be constructed on the site of the Douglas Building as expanded by the Post Office tract. (R-22)

On February 5, 1958, a supplemental lease agreement between the University of Washington and petitioner added the Post Office tract to the property covered under the original lease. (Jt. Ex. 4-D) The supplemental lease agreement recited the purpose of said agreement as being to preserve and improve the status of the premises previously demised to petitioner as a business center of the first class by the replacement of the Douglas Building with a new building to be located on the Douglas Building site enlarged by the addition of the adjoining Post Office tract. (Jt. Ex. 4-D, p. 1)

The consideration for the inclusion of the Post Office tract property into petitioner's leasehold was stated in said supplemental lease agreement to be petitioner's assumption of its lessor's undertakings and agreements with respect to the construction of the new Post Office building for the United States of America on the portion of the Post Office site retained by the United States. (Jt. Ex. 4-D, p. 2)

It was separately stated in said supplemental lease agreement that petitioner, lessee, would pay to the lessor the sum of $80,000 on November 1, 1960; and the sum of $80,000 on November 1, 1961; and the sum of $80,000

on November 1, 1962, as additional rentals over and above all rentals provided for under the terms of the original lease. (Jt. Ex. 4-D, p. 3)

Construction of the Supplemental Lease Agreement

Petitioner and its lessor each treated the payments here involved as current rent payments in their respective books of account. (R-22)

The supplemental lease agreement provided that as to any new structure located on the Post Office tract, such structure would be subject in all respects to the rights and obligations of the parties thereto as set forth in the original lease with respect to the original structures upon the property demised under the said original lease. (Jt. Ex. 4-D, p. 3) Thus, the original lease and the supplemental lease agreement were to be construed together to arrive at a determination of the rights and obligations of the parties thereto.

In its Opinion, the Tax Court concluded that the designation by the parties to the supplemental lease agreement of the payments in question as rentals was not controlling. (R-32)

The Tax Court further inferred that during the period in question, the Douglas Building would be in the process of destruction and the Washington Building in the process of construction and the site, therefore, nonincome producing (R-33) In fact, the Washington Building was formally opened for occupancy on June 2, 1960. (R-22) The Tax Court further inferred that the rent abatement provision of the original lease would be applicable to the period in question so that "it would seem logical that instead of paying additional rent for these three years, petitioner's

ent would have been reduced while the property was ion-income producing, rather than increased." (R-34) Petitioner made rent payments for the years here in question which exceeded the one million dollar minimum yearly rental guaranteed in the original lease (Jt. Ex. 1-A, p. 1 and 2-B, p. 1), which payments rendered said rent abatement provision inapplicable to said years.

The Tax Court relied principally on such cases as *Main & McKinney Building Co. v. Commissioner,* 113 F.2d 81 and *Southwestern Hotel Co. v. United States,* 115 F.2d 686 to conclude that the payments here in question could be construed as advance rentals. (R-32, 33)

Deductibility of Payments as Ordinary and Necessary Business Expenses

Petitioner argued in the alternative that the payments in question should be deductible as ordinary and necessary business expenses. The supplemental lease agreement demonstrated the obligation of petitioner to maintain the demised premises, including that portion upon which the Douglas Building was located as a center of store and office buildings of the first class and that in order to accomplish that purpose to preserve and improve the status of the tract as a business center of the first class, a new building should be located on the site formerly occupied by the Douglas Building, as enlarged by the addition of the Post Office tract. (Jt. Ex. 4-D, p. 1) The Tax Court concluded that assuming that the $80,000 payments were made for the acquisition by petitioner of the Post Office tract portion of its leasehold, such payments were not ordinary and necessary business expenses of the petitioner for the reason that such expenses were

not incurred in the everyday operation of petitioner's business and that the same were not required to be made. (R-36)

QUESTIONS PRESENTED

On the basis of the above and foregoing statement of the case, the following questions are presented:

1. Did the Tax Court err in refusing to accept the characterization of the payments in question of the parties to the supplemental lease agreement as current rentals?

2. Did the Tax Court err in its tacit finding that the premises in question would be non-income producing during the fiscal years ended Oct. 31, 1961 and Oct. 31, 1962, here involved due to the destruction of the Douglas Building and the construction of the Washington Building?

3. Did the Tax Court err in inferring that the rent abatement provision of the original lease would be applicable to the premises in question during the periods here in question?

4. Did the Tax Court err in relying on the *Main* & *McKinney Bank Building* and the *Southwestern Hotel Company* cases, *supra,* in concluding that the designation of the payments by the parties as current rentals could be disregarded?

5. Did the Tax Court fail to apply the appropriate legal standard to the facts of this case in order to determine whether the payments in question were ordinary and necessary business expenses under 26 U.S.C.A. §162 (a), Int. Rev. Code of 1954?

SPECIFICATIONS OF ERROR

1. The Tax Court erred in concluding that the payments were advance rentals or capital expenditures. (R-32)

2. The Tax Court erred in disregarding the parties' characterization of the payments as current rentals. (R-32)

3. The Tax Court erred in considering the rent abatement clause of the original lease in construing the supplemental lease agreement. (R-33, 34)

4. The Tax Court erred in its finding that the Douglas Building site as enlarged by the Post Office tract was non-income producing during the fiscal years in question. (R-33, 34)

5. The Tax Court erred in relying on cases cited at R-32, 23 to support its conclusion that the payments here in question were advance rentals or capital expenditures.

6. The Tax Court erred in its tacit conclusion of law that sums paid for untenantable property cannot be considered current rents.

7. The Tax Court erred in concluding that an "ordinary and necessary" business expense under 26 U.S.C. §162 is one which is required and made in the everyday operation of a taxpayer's business. (R-36)

8. The Tax Court erred in concluding that the payments herein were not ordinary and necessary business expenses.

SUMMARY OF THE ARGUMENT

I. The Tax Court erred in concluding that the payments were not current rentals.

A. The Tax Court erred in disregarding the purpose of the payments as current rentals.

B. The Tax Court's implied finding that the rent abatement clause was applicable to the transaction in question is clearly erroneous.

C. The Tax Court erred in its tacit conclusion of law that sums paid for untenantable property cannot be considered current rents.

D. Cases cited by the Tax Court do not support its conclusions that the payments were advance rentals or capital expenditures.

E. This court's review is not limited by the "clearly erroneous" rule.

II. The Tax Court erred in concluding that the $80,000 payments were not deductible as ordinary and necessary expenses under Int. Rev. Code 1954, 26 U.S.C. §162(a).

A. The Tax Court applied an erroneous standard of deductibility.

B. The evidence supports the deductibility of the payments as ordinary and necessary business expenses.

ARGUMENT

I. The Tax Court Erred in Concluding That the Payments Were Not Current Rentals

A. The Tax Court erred in disregarding the purpose of the payments as current rentals.

In 2 Mertens, *Law of Federal Taxation*, §12.36, it is stated:

"Where the lessee continues to occupy the premises under a new or modified lease, the amount paid by the lessee should be either deductible in full in the year of payment or amortized over the life of the lease depending on the underlying purpose of the payment. Where the payment is not required as a condition to the rental of the property in the future and where the parties specifically agree that the payment is unconditional and is earned at the time it is made, the payment should not be treated by the lessee as prepaid rental or as the cost of acquiring a new or modified lease and should not be spread over the period of the lease."

The controlling statutory guide herein is 26 U.S.C.A. §162, (I.R.C. 1954) which provides:

"(a) In General—There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including— * * * (3) rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity."

The basic problem is, therefore, one of characterizing the payments here in question as current rental expenses or as capital expenditures; and this characterization is dependent upon the underlying purpose for the payments. Thus, the inquiry here is whether the underlying purpose of the payments was to secure the future use and possession of the leasehold property added by the supplemental lease agreement or whether the sums paid were consideration for the current use or possession of the demised premises.

The consideration for petitioner's right to the future use and possession of the portion added to the petitioner's

original leasehold is clearly stated in the supplemental lease agreement.

> "Whereas, lessor entered into said contract with the General Services Administration of the United States of America upon the understanding and agreement with lessee that the portion of the present Post Office site and the rights and privileges in connection therewith to be acquired by the lessor would be added to and incorporated in the Metropolitan Tract area covered by said lease of July 18, 1953, subject to all of the terms and conditions of said lease, and that *in consideration therefore lessee would undertake to fulfill and perform all of lessor's undertakings and agreements with respect to the construction of the new Post Office Building for the United States of America* * * *". (Emphasis supplied) (Jt. Ex. 4-D, p. 2)

On the other hand, the questioned $80,000 payments were provided for under a separate heading and identified by the parties as "rentals."

> "2. Lessee will pay to the lessor the sum of $80,-000 on November 1, 1960; the sum of $80,000 on November 1, 1961; and the sum of $80,000 on November 1, 1962, as additional rentals over and above all rentals provided for under the terms of said lease." (Jt. Ex. 4-D. p. 3)

The parties also demonstrated the purpose and mutual characterization of the payments as current rentals by so treating them in their respective books of account. (R-22) Assuming that the purpose for the payments was not clearly stated in the supplemental lease agreement, the mutual construction of the payments by the parties is compelling evidence of their characterization of the payments as current rents. The following rule of construction is stated in 17 Am. Jur. 2d, *Contracts*, p. 683-685, §274:

"In the determination of the meaning of an indefinite or ambiguous contract, the construction placed upon the contract by the parties themselves is to be considered by the court. Unquestionably, the practical construction or uniform conduct or practice of the parties under a contract is a consideration of much importance in ascertaining its meaning, and that consideration is entitled to great, if not controlling, influence in ascertaining the parties understanding of the contract terms and language, since the parties are in the best position to know what was intended by the language employed."

In *Hyde Park Realty, Inc. v. Commissioner of Internal Revenue*, 211 Fed. 462 (2nd Cir., 1954), the court, in determining whether the payments there in question were to be considered as a reduction in the purchase price of certain real property or as rentals, relied upon the fact that "There can be no doubt on the record that both parties treated the sum as rent" (p. 463) to conclude that the payments made were in fact current rentals. Here also, the subsequent, harmonious treatment of the $80,000 payments by both parties is compelling evidence of the proper characterization thereof as current rentals.

Where, as here, the parties have dealt at arms-length and the transactions are not illegal or contrary to public policy, "nor on their face designed as an ingenious scheme or devise to avoid payment of taxes," the purpose and characterization of the payments as set forth in the parties' written agreement will control. *Western Contracting Co. v. Commissioner of Internal Revenue*, 271 F.2d 694, 699 (8th Cir. 1959).

In respect to the designation of the purpose for the payments here involved, "the parties had full liberty to contract as they pleased." *Benton v. Commissioner of*

Internal Revenue, 197 F.2d 745, 752 (5th Cir. 1952).

Here also, the Tax Court is not at liberty to "make a new agreement for the parties," to disregard the parties' stated consideration for the acquisition of the additional leasehold property, to disregard their designation of the $80,000 payments as rentals, and to ignore the subsequent uniform treatment of the payments by both parties to the Supplemental Lease Agreement as current rents.

The Tax Court's statement that "The supplemental lease agreement makes no explanation of why the 'additional rentals' were to be paid" (R-33), is clearly refuted by the above facts. Moreover, it is extremely unlikely in common experience that a "reason" for the designation of a payment as rental would be stated in a lease agreement because the terms "rent" or "rental" by definition set forth the reason for the payment as being consideration for the use or occupation of property, *Black's Law Dictionary,* 4th Ed., 1957.

The purpose of the payments as shown by the supplemental lease agreement as written and construed by the parties is vividly disclosed by the record as consideration for the current use and possession of the premises. The above cited authorities demonstrate that to disregard such purpose is error as a matter of law.

B. The Tax Court's implied finding that the rent abatement clause was applicable to the transaction in question is clearly erroneous.

The following excerpts from the Tax Court's opinion are quoted at length to illustrate the extent to which the Tax Court relied upon the rent abatement clause of the

lease agreement of 1953 (This clause appears at Jt. Ex. 3-C, pp. 7, 8.)

> "Petitioner would receive no income from the use of the property added to the original lease during the years here involved, at least until the Washington Building was completed and rented." (R-33)
>
> "Under the terms of the original lease, if any of the demised buildings were to become untenantable during the terms of the lease, the rental paid by the petitioner to the lessor was to be reduced while such condition prevailed. It would seem logical that instead of paying additional rents for these three years, petitioner's rent expense would have been reduced while the property was non-income producing, rather than increased. Of course, this would have been the situation while the Douglas Building was being built, except for the payments here involved." (R-34)
>
> "We do not think it reasonable, likely or a fact that petitioner would pay $80,000 per year additional rental for the leased property during the years here involved, *when the property would produce less rental income to petitioner than before. . . .*" (Emphasis supplied) (R-34)

The facts assumed by the above statements are (1) that the premises demised by the supplemental lease agreement together with the site occupied by the Douglas Building were non-income producing during the fiscal years here involved and (2) that the rent abatement clause of the original lease agreement was applicable to the transactions contemplated by the supplemental lease agreement.

First, the assumption that the premises were non-income producing during the periods in question is absolutely contrary to the evidence. The construction of the Washington Building was completed and the

building formally opened to occupancy on July 2, 1960 (R-22), whereas the first additional rental payment under the supplemental lease agreement was payable for the fiscal year November 1, 1960 to October 31, 1961. (Jt. Ex. 4-D, p. 3)

Secondly, the rent abatement clause of the original lease agreement provided in part:

> "It is further agreed that if for any reason other than default of lessee, any portion of the demised premises shall not be capable of being occupied, operated, or used by the lessee, the annual *minimum guaranteed rent* shall be reduced for the period of time said space remains untenantable in the amount of what would have been lessor's percentage rent from the untenantable space if said space had been tenantable. . . ." (Emphasis supplied) (Jt. Ex. 3-C, p. 8)

Thus, only the minimum guaranteed rent ($1,000,000 per year during the fiscal years in question (Jt. Ex. 3-C, p. 4)) was to be abated. The abatement clause would not be applicable in the year in which rent otherwise payable by petitioner exceeded $1,000,000. During the fiscal years in question, the rents paid by petitioner to its lessor were $1,852,413, and $2,010,929, respectively (Jt. Ex. 1-A, p. 1 and 2-B, p. 1, respectively).

Even if the factual bases for the Tax Court's opinion were accurate, it is clear that the rent abatement clause would be inapplicable to the transaction contemplated by the supplemental lease agreement. That agreement provided that "any new structure located" on the Post Office Tract "shall be subject in all respects to the rights and obligations of the parties as set forth in said lease

with respect to the original structures on the demised premises." (Jt. Ex. 4-D, p. 3). The rent abatement provision was thus not intended to apply to the Post Office Tract while no "new structure" was located thereon. Thus, the rent abatement clause, even if otherwise applicable, would not apply to the Post Office Tract unless and until a new structure, completed thereon, subsequently became untenantable.

C. The Tax Court erred in its tacit Conclusion of Law that sums paid for untenantable property cannot be considered current rents.

There is inherent in the foregoing quotations from the Tax Court's opinion, *supra*, p. 15, the legal premise that sums paid for the use of temporarily nonincome producing property are non-deductible as current rentals. Even if it were true that the premises added by the supplemental lease agreement were non-income producing during the periods in question, such fact would not preclude the treatment as current rents of monies paid for the use of such premises by a petitioner. In *Flambeau Plastics Corp.*, 22 T.C.M. 112, T.C. Memo 1963-29, the commissioner took the position that the designation of monthly payments by the taxpayer to its lessor as "rents" was a mere label and did not represent the true character of the payments, which the commissioner characterized as capital expenditures for the acquisition of the leasehold. The lease agreement there contemplated the construction of a new building on the leased premises, and provided for a fixed yearly rental. The commissioner disallowed a rent payment deduction taken by the taxpayer for the period during

which the premises were untenantable because of the construction of improvements. The Tax Court held that the taxpayer was entitled to deduct the entire payment as rent, stating:

> "To hold otherwise, would be to say that a taxpayer who acquires the right to eventually use land by virtue of a lease arrangement must use it in the course of the carrying on of the trade or business before he may be said to have the use thereof under the statute. The words of §162(a)(2) are broader in their scope. The phrase 'for purposes of trade or business' of the taxpayer evidences a clear congressional intent that such use or possession need not be limited to the *carrying on* of a trade or business, but falls within the statutory intendment if the use *or* possession is for the *purposes* thereof. Certainly the petitioner was using the premises within the statutory meaning (when) immediately it began to oversee and supervise the construction of the building which construction clearly had no other purpose than to house the petitioner's business." page 115.

Thus, if it is assumed that the $80,000 payments were made for the use and possession of the Post Office tract portion of petitioner's leasehold while such property was non-income producing such fact would not render the payments nondeductible.

D. Cases cited by the Tax Court do not support its conclusion that the payments were advance rentals or capital expenditures.

In its opinion, the Tax Court relied primarily on *Southwestern Hotel Co. v. U.S.*, 115 F.2d 686, 688 (5th Cir. 1940), *Main & McKinney Building Co. v. Commissioner*, 113 F.2d 81 (5th Cir. 1940) and *Baton Coal Co. v. Commissioner*, 51 F.2d 469 (3rd Cir. 1931), affirming 19 B.T.A. 169, to support its conclusion that the pay-

ments here involved were not deductible by petitioner, but were advance rentals or capital expenditures. (R-32, 33)

The claimed deductions in each of the above cases involved payments made, or contracted to be made, as part of agreements covering the initial acquisition of a leasehold. On the other hand, we are here concerned with an incidental modification, by the supplemental lease agreement of the lease agreement of 1953 under which the principal portion of petitioner's leasehold was demised.

Moreover, in *Southwestern*, the court's conclusion that the claimed deductions were in fact advance rentals or capital expenditures was based, in part, upon the finding that the amounts so paid were *grossly disproportionate* to the "rentals" reserved for the later years of the lease term. The court in *Southwestern* stated as to the characterization of the payments claimed as deductions:

> "The determination of this ultimate question is reached by deciding whether the payments were rental for the use and occupancy of the premises during the particular year in which it was made, or whether it was advance payment of rental which exceeded the actual value of the use for the year in which it was paid, and which was made in consideration for a lease for a longer period of time. We think this question is clearly answered by an examination of the schedule of payments due under the mortgage debt. On May 1, 1940, a payment of $265,000 was due on the mortgage, and during that same tax year $18,000 was due to the lessor. Contrasted to that, in 1941 and each subsequent year, the total annual rental due was only $24,000 to $30,000. It is also true, that for each of the years that the payments on the mortgage debt were due, the total annual payments made in consideration of the lease were substantially larger than the rentals due after the

> satisfaction of that debt. Under these circumstances, it is unreasonable to believe that the payment to the mortgagee, when added to the rent paid to the lessor, aggregated the amount paid for the rent paid for the premises during the tax year." Pages 687, 688.

And in the *Main & McKinney* case, the court observed:

> "The error of petitioner's theory is made apparent by another view of the case. The only consideration moving from it to its grantor, the original lessee, after the cash payment, was the payment of the $10,000 per year for 25 years. If these payments are to be considered rentals rather than extended payments of the purchase price, the payment thereof at a specified rate entitled petitioner to use the premises for a period of 73 years without paying any rent therefor. Clearly, therefore, these payments, if rentals were advances returning benefits over the 98 year period of the lease, for which only aliquot deductions, commensurate with the ratio of the exhaustion of the lease, may be taken." page 114.

In *Baton Coal Co.*, the opinions of both the Board of Tax Appeals and the Circuit Court are so devoid of fact as to provide little, if any, basis for reliance thereon as authority for the resolution of issues in the case at bar.

In the instant case, the facts clearly show that the payments in question were not disproportionate to the rents reserved under the original lease (fixed rents were reserved under the lease agreement of 1953 for the lease years commencing November 1, 1954, November 1, 1955, November 1, 1956 and November 1, 1957, in the amounts of $1,600,000; $1,700,000; $1,700,000 and $1,800,000, respectively. Thereafter, a rental based upon a percentage of the lessee's gross rent receipts from its tenants was reserved, with a minimum guaranteed rental of $1,000,000.00 per year). (Jt. Ex. 3-C, pages 3 and 4)

And when the $80,000 payments are viewed in the perspective of the leasehold as expanded by the supplemental lease agreement, case law premised upon evidence of substantially disproportionate payments becomes totally inapplicable.

Other cases cited by the Tax Court lend little, if any, support to its conclusions. *Oscar L. Thomas*, 31 T.C. 1009 (cited by the Tax Court at R-32, 23) tends to support the petitioner's position. In that case the Tax Court, in allowing the deduction claimed by the taxpayer, observed at page 1012:

> "There is nothing in the record to indicate that the parties were not dealing with one another at arm's length or that the rental was unreasonable, or that there was some undisclosed agreement that a portion thereof was to represent the cost of acquiring a leasehold interest."

Similarly, there is nothing in the record of the instant case to indicate that the parties were not dealing with one another at arm's length, or that the rental was unreasonable, or that there was some undisclosed agreement that the additional rental was to represent the cost of acquiring the increment to the leasehold interest.

The following cases cited by the Tax Court have so little factual similarity to the case at bar that their citation contributes little force to the Tax Court's conclusions.

Alexander W. Smith, Jr., Executor, 20 B.T.A. 27 (1930) (cited at R-32), involved the question of deductibility of payments by a "lessee" under an agreement which allowed the "lessee" to obtain title to the "demised" property by payment of $10.00 to the "lessor" at the end of

the "term". A fee simple deed to the premises was deposited in escrow by the "lessor" to be delivered to the lessee upon compliance by the "lessee" with the terms of the agreement. The court determined that the "lease" was in fact an installment sale contract, and that the payments were therefore purchase installments rather than rents.

In *Lola Cunningham*, 39 T.C. 186 (1962) (cited at R-33), the decision sustained the *taxpayer's contention that the payment in question was an advance rental* and was deductible in the year designated for its application by the parties to the lease agreement.

Joseph J. Neel Company, 22 T.C. 1083 (1954) (cited at R-33), involved the question of whether the taxpayer-lessee could amortize and deduct an alleged obligation to improve the demised premises or to pay in lieu of such improvements a stipulated sum at the end of the lease term. *The taxpayer contended that the alleged obligation was the acquisition cost of the leasehold,* and as such was subject to amortization and deduction over the term of the lease. The Commissioner claimed that the obligation was contingent and, therefore, not subject to amortization or deduction. The Court held that the obligation was fixed and not contingent, and that the taxpayer could amortize and deduct the obligation over the term of the lease.

E. This court's review is not limited by the "clearly erroneous" rule.

Int. Rev. Code 1954, 26 U.S.C. §7482 provides in part:

> "The United States Courts of Appeal shall have exclusive jurisdiction to review the decisions of the

> Tax Court, except as provided in Section 1254 of Title 28 of the United States Code, in the same manner and to the same extent as decisions of District Courts in civil actions tried without a jury. . . ."

Rule 52(a), Federal Rules of Civil Procedure, 28 U.S.C., sets forth the rule relating to review of findings of fact by a trial court in civil actions tried without a jury. Rule 52(a) states in part:

> "Findings of Fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge the credibility of witnesses."

The evidence in the instant case consisted entirely of stipulated facts and documents. The Tax Court based its decision principally upon its construction and interpretation of the lease agreement and supplemental lease agreement (Jt. Exs. 3-C and 4-D, respectively). The Tax Court was not called upon to weigh testimony or judge credibility of witnesses. Under these circumstances this court is concerned not with questions of fact and the "clearly erroneous" rule, but with questions of law. In ascertaining whether or not the supplemental lease agreement is ambiguous as written and construed, and in interpreting the lease agreement and the supplemental lease agreement, this court is not bound by the findings or inferences of the Tax Court, for in such matters the court is principally concerned with questions of law. *Republic Pictures Corp. v. Rogers*, 213 F.2d 662, 664, 665, (9th Cir. 1954).

The misplaced reliance of the Tax Court upon the rent abatement clause together with the fact of the parties' express characterization of the payments as rentals, both

in word and deed, militate against a characterization of the payments as anything but current rentals. There is absolutely no evidence in the record to support a characterization of the rentals as advance rentals, and no basic facts or inferences drawn therefrom, except those which were tainted with error in law or with misinterpretation by the Tax Court of documentary evidence, which would support a conclusion that the payments should be characterized as capital expenditures.

An additional error of law is implicit in the Tax Court's reliance upon its assertion that:

> "Petitioner would receive no income from the use of the property added to the original lease during the years here involved, at least until the Washington Building was rented and completed." (R-33).

The tacit legal conclusion of the above is that current deductions may not be taken for payments connected with non-income producing properties. The error in this legal conclusion is exemplified by *Flambeau Plastics Corp., supra,* pages 17-18. Where the trial court's findings are induced by, or its conclusions based upon, an erroneous view of the law, the same are not binding on the reviewing court. *Smallfield v. Home Insurance Co. of New York,* 244 F.2d 337 (9th Cir. 1957); Vol. 2B, Barron & Holtzof, *Federal Practice & Procedure,* §1137, pp. 559-561.

II. The Tax Court Erred in Concluding That the $80,000 Payments Were Not Deductible as Ordinary and Necessary Expenses Under Int. Rev. Code, 1954, 26 U.S.C. Sec. 162(a).

A. The Tax Court applied an erroneous standard of deductibility.

The Tax Court concluded that the $80,000 payments constituted the consideration for the acquisition of the Post Office tract, and that such payments were, therefore, capital expenditures. Int. Rev. Code 1954, 26 U.S.C. §162(a) contemplates the deductibility of *ordinary and necessary business expenses,* including rentals or other payments required to be made as a condition to the continued use or possession of the demised property. The Tax Court denied the deductibility of the payments by petitioner on the ground that:

> "* * * We have no evidence that the petitioner was *required* to make these $80,000 payments in connection with the *everyday operation* of its business." (Emphasis added) (R-36)

Thus, the standard of law applied by the Tax Court equated the terms "required" and "everyday operation" to the terms "necessary" and "ordinary", respectively, appearing in §162(a). Where the conclusion of the trial court is induced by a misapprehension of the applicable legal standard, the conclusions must be rejected as clearly erroneous. *Mitchell v. Raines,* 238 F.2d 186, 187 (5th Cir. 1956).

To be "ordinary and necessary" an expense need not be one required to be made in the everyday operation of a taxpayer's business. The applicable standard of law, as distinguished from the erroneous standard applied by the Tax Court, is illustrated by the following citations:

> "An expense may be ordinary even though it happens but once in the taxpayer's lifetime. For an expenditure to be necessary, it is not essential that there be an absolute and compelling reason. When the expenditure is appropriate and helpful to the taxpayer's business, the courts are loath to override the

taxpayer's judgment." *Cravens v. Commissioner of Internal Revenue*, 272 F.2d 895, 898, 899 (10th Cir. 1959).

"When is an expense necessary? An expense will be ordinarily considered 'necessary' if the expenditure is appropriate and helpful to the development and maintenance of the taxpayer's business. Obviously, under such a view, the necessity is not absolute or inexorable." Mertens, *Law of Federal Income Taxation*, chap. 25, p. 24.

"The concept of 'ordinary' under the Code does not require that the expenditure be either habitual or normal in the sense that a taxpayer makes or is required to make them often; the expenditure may be ordinary even though unique or non-recurring to the taxpayer affected." *Ibid*, page 27.

"The non recurring nature of the disbursement does not preclude deductibility; nor does its mere dollar amount. Expenditures made in accordance with trade usages and the requirements of good practices may be deducted, even though there is no legal obligation to make them. Similarly, expenditures made to retain or protect and promote the normal continuance of an established business are deductible, as are expenditures made to retain customer good will." *Connecticut Light & Power Co. v. United States*, 299 F.2d 259, 264 (Ct. Cl, 1962).

It is evident from the above that the Tax Court failed to apply the appropriate legal standard of deductibility to the facts of this case. It follows that the Tax Court decision must be reversed.

B. The evidence supports the deductibility of the payments as ordinary and necessary business expenses.

Assuming, for purposes of argument, that the Tax Court's conclusion that the payments herein were consideration for the acquisition of the Post Office parcel incre-

ment to petitioner's leasehold, it does not follow that the payments made by petitioner were to be capitalized, and that the same were not currently deductible. The following case law supports the deductibility of the payments made by petitioner herein as ordinary and necessary business expenses.

In *Wyoming National Bank of Casper, Wyoming*, 23 B.T.A., 408 (1931), the taxpayer deducted as additional rentals payments of $10,000 each in the years 1922 and 1923, in addition to the yearly rental of $10,000 reserved under its lease. The additional rentals were consideration for speeding up construction of a building to be occupied by the taxpayer on the leased premises, and to cover the costs of certain alterations and improvements in the building requested by the taxpayer. The evidence showed that at the time in question the taxpayer was quartered in an old building which was unsuited to its business and inadequate. The improvements, alterations and betterments requested and paid for by the taxpayer were of a permanent nature. The deductions of the "additional rentals" were disallowed by the Commissioner and were characterized by him as capital expenditures to be amortized over the term of the lease. The Tax Court concluded that the amounts paid by the taxpayer in consideration of the lessor's speeding up the construction and making the improvements were not capital expenditures and held that the Commissioner erred in disallowing the claimed deductions.

The facts of the instant case require the same result. As recited by the Tax Court, (R-29), the building located on the side adjacent to the Post Office tract was the "smallest and least profitable" of the

Metropolitan Tract buildings; an inadequate building, unsuited to petitioner's use of the demised premises.

The motivation for the inclusion of the Post Office tract was illustrated by the Supplemental Lease Agreement:

> "* * * said lease (1953) *requires* the lessee to operate the various structures then or thereafter constructed upon the demised premises in such a manner as not to injure the reputation thereof and to maintain the demised premises as a center of store and office buildings of the first class, and at all times to so operate the tract as to produce the maximum return consistent with the character of the tract; and
>
> "* * * the parties have determined that, in order to accomplish these purposes and to produce a maximum return for the lessor and to preserve and improve the status of the tract as a business center of the first class, the contemplated new building to replace the Douglas Building should be located on its present site enlarged by the addition of an adjoining tract now a part of the present Post Office site and which is described as follows * * *" (Emphasis added) (Ex. 4-D, p. 1).

The duty of petitioner to its lessor to undertake and fulfill the obligations set forth in the lease agreement of 1953 and the supplemental lease agreement; i.e., to maintain the character of the originally demised premises as a center of store and office buildings of the first class, existed by virtue of contract. Thus, the necessity for petitioner's expenditures herein was more compelling than that set forth in the *Wyoming Bank* case.

But even lesser degrees of "necessity" will suffice under §162(a). In *Cubbedge Snow*, 31 T.C. 585 (1958), the taxpayer, a law firm, was allowed to deduct

as ordinary and necessary business expenses expenditures made by it to cover losses incurred by a federal savings and loan association organized by the taxpayer. The taxpayer had organized the association to provide a new source of abstract fees for its law business, in order to fully utilize the taxpayer's abstracting books, files and records which it had accumulated over previous years. There, as here, the Commissioner had disallowed the taxpayer's claimed deduction as being a capital expenditure. The Court stated:

> "The crucial and controlling factor lies in determining whether the acts done and expenditures made were motivated by the purpose to protect or promote the taxpayer's business or made as an investment in a new enterprise." p. 591.

> "While capital expenditures ordinarily result in the acquisition of assets having periods of useful life in excess of one year it does not follow that an expenditure must be deemed a capital outlay merely because the ultimate benefit may accrue in a year or years subsequent to the year of payment." p. 593.

The Court further explained its position by distinguishing *Carl Reimers Co.*, 19 T.C. 1225, 1239 (1953) as follows:

> "The outlays there were not made, as they were in the instant case, for the purpose of protecting, retaining or adding to the business which the taxpayer already had, but to fulfill a prerequisite to the attainment of something new." p. 593.

The court concluded that the payments were deductible by the taxpayer.

Again, assuming the Tax Court's conclusion that the payments were here made for the acquisition of the Post

Office property increment to petitioner's leasehold, the purpose of the acquisition was to protect or add to the business which the petitioner already had, as is indicated by the language in the supplement lease agreement quoted *supra*, p. 28.

That expenditures to meet demands of business change and competition are deductible is illustrated by *Connecticut Light & Power Co. v. U.S., supra*, p. 26. There, the taxpayer claimed a deduction for the total costs incurred by it in converting its business from the distribution of manufactured gas to the distribution of natural gas. To accommodate this change, the taxpayer altered its distribution pipelines and fittings and its customer's burner units in order to handle the dryer, higher BTU rated natural gas. The court concluded that expenditures made in the "normal continuance of an established business" are deductible. That term encompasses the situation where a taxpayer incurs an expense to up-date and in fact to change in nature the assets of his existing business. The scope and philosophy of the court's opinion is illustrated by the following statement:

> "In this competitive, fast moving age, there is no such thing as industrial stand-still." *Ibid*, page 266.

Where expenditures are made by a taxpayer for the acquisition of an asset as an incident to the conduct of its business, such purchase being motivated by business rather than investment purpose, the asset so acquired is properly characterized as a non-capital asset. The loss, if any, realized on the sale of such an asset is characterized as an ordinary and necessary business expense and is fully deductible under Int. Rev. Code 1954, §162(a). *Commissioner of Internal Revenue v. The Bagley &*

Sewall Co., 221 F.2d 944 (2nd Cir. 1955). (Government bonds purchased as security for a performance of contract); *Booth Newspapers, Inc. v. United States*, 303 F.2d 916. (Ct. Cl 1962) (Purchase of plant and inventory of newspaper manufacturers in order to insure supply to taxpayer). Although these cases deal with losses, the significance of their holdings lies in the characterizations of the acquisitions as non-capital assets. This characterization is dependent upon the motivation of the taxpayer, whether for business or investment purposes, for the acquisition. The motivation for the execution of the supplemental lease agreement is quoted, *supra*, page 28, and constitutes a clear expression of the petitioner's motivation, and that of its lessor, to add the Post Office tract as an incident to the business operation of the originally demised premises. (The premises added by the supplemental lease agreement constituted an area of only 4,400 square feet (R-21), and the stated purpose for its acquisition was to enlarge the Douglas Building site to facilitate the construction of the Washington Building). There is no evidence of a motivation to acquire the Post Office tract increment to petitioner's original leasehold as a separate investment property.

CONCLUSION

Because of the nature of the record on this review, the evidence consisting entirely of stipulated facts and documents, this Court has the power to reverse the Tax Court and to enter its decision in favor of petitioner. Based upon the following conclusions, respectfully urged by petitioner as being supported by the facts and law

presented herein, such reversal and decision by this Court is fully justified.

1. The characterization of the payments as current rents is supported by their designation as such in the supplemental lease agreement and the clear distinction in said agreement between the additional rents reserved and the consideration for the inclusion of the Post Office tract. Moreover, the mutual treatment of said payments as current rents by the parties to said agreement is compelling evidence of such characterization.

2. Even if not characterized as current rents, the evidence supports the characterization of the payments as ordinary and necessary business expenses, made to protect and promote petitioner's existing business.

3. The Tax Court's conclusion that the payments were not current rents is premised upon the assumed but clearly erroneous fact that the premises were non-income producing during the periods in question; and upon the equally erroneous legal conclusion that the rent abatement clause of the original lease would have been applicable during the period in question.

4. The Tax Court's conclusion that the expenditures were not ordinary and necessary expenses was based upon an erroneous construction of 26 USC 162(a) (Int. Rev. Code 1954) and the resulting application of an improper standard of law to the facts herein.

Respectfully submitted,

DeWitt Williams
Attorney for Petitioner

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with these rules.

DeWitt Williams
Attorney for Petitioner

APPENDIX A

Table of Exhibits Pursuant to
Rule 18(2)(f) as Amended:

Joint Exhibits		*Offered*	*Admitted*
1-A	U.S. Corporation income tax return of petitioner for fiscal year ended October 31, 1961	R-61,62	R-62
2-B	U.S. Corporation income tax return of petitioner for fiscal year ended October 31, 1962		
3-C	Lease agreement between petitioner and University of Washington, dated July 18, 1953	R-61,62 R-61,62	R-62 R-62
4-D	Supplemental lease agreement between petitioner and University of Washington, dated February 5, 1958	R-61,62	R-62

NOTE: Exhibits E, F, G and H were offered by respondent (R-62). Petitioner objected to their admission (R-62). The Tax Court did not rule on their admissability for the reason that it did not consider such Exhibits in rendering its decision, and stated that said exhibits were not the best evidence and were of little probative value. (R-35)

No. 21037

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

UNIVERSITY PROPERTIES, INC.,

Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

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IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

UNIVERSITY PROPERTIES, INC.,

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v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

OPINION BELOW

The opinion of the Tax Court (R. 24-37) is reported at 45 T.C. 6.

JURISDICTION

By a statutory notice (R. 7-11) issued under date of April 20, 64, pursuant to Section 6212 of the Internal Revenue Code of 1954, e Commissioner of Internal determined deficiencies in federal income xes against University Properties, Inc. (herein sometimes referred as the taxpayer), for the fiscal years ended October 31, 1961 and 62, in the respective amounts of $40,114.29 and $38,573.53. A timely tition for redetermination of such deficiencies (R. 2-6) was filed the taxpayer with the Tax Court on July 16, 1964, pursuant to ction 6213 of the 1954 Code. The issues involved were submitted to e Tax Court on a stipulation of facts (R. 19-22) and documentary hibits (not included in the duplicated record). On January 31, 1966,

the Tax Court filed its opinion (R. 24-37) affirming the Commissioner's determination, and on February 1, 1966, entered its decision (R. 38) re-determining deficiencies for the taxable years in issue in the respective amounts determined by the Commissioner. The taxpayer's petit for review of the Tax Court's decision by this Court (R. 39-42) was timely filed on April 27, 1966. Jurisdiction is conferred on this Court by Section 7482 of the Internal Revenue Code of 1954.

QUESTION PRESENTED

Whether the Tax Court erred in affirming the Commissioner's determination that additional payments of $80,000 made by the taxpayer to its lessor in each of the taxable years in issue, pursuant to a supplemental lease agreement which added additional rental properties to those covered by an existing lease agreement between the parties, are to be amortized over the remaining term of the lease agreement for federal income tax purposes, rather than deducted from gross income in the years of payment, as contended by the taxpayer, as current rental payments or other ordinary and necessary business expenses of the years in which paid.

STATUTE INVOLVED

Internal Revenue Code of 1954:

SEC. 162. TRADE OR BUSINESS EXPENSES.

(a) In General.--There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including--

* * *

(3) rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

* * *

STATEMENT

This proceeding involves deficiencies in federal income taxes for the fiscal years ended October 31, 1961 and 1962. The facts, supplemented by certain documentary evidence, were stipulated before the Tax Court (R. 19-22), and are summarized in the Tax Court's opinion (R. 24-31).

The taxpayer, University Properties, Inc., was incorporated under the laws of the State of Delaware on July 6, 1953, with authorized capital of 50,000 shares of common stock, par value $1 per share, all issued and outstanding during the period here involved. Since incorporation, its principal office has been at 210 White-Henry-Stuart Building, Seattle, Washington. It filed its federal corporation income tax returns (Exs. 1-A, 2-B) for the years in issue with the District Director of Internal Revenue, Tacoma, Washington. (R. 19, 25.)

The University of Washington originally occupied a 10-acre site which is now in the heart of downtown Seattle. In the 1890's a 583-acre section was purchased and it became the new permanent campus of the University of Washington. In 1902 a small parcel of the original campus was sold to the Federal Government as a post office site. On November 4, 1904, the balance of the tract, commonly known and hereinafter referred to as the Metropolitan Tract, was leased to James A. Moore for a term of 50 years from November 1, 1904. Three years later the lease was assigned to the Metropolitan Building Company, an organization which undertook to erect buildings and otherwise improve the property. That company constructed the White-Henry-Stuart, Skinner, Stimson, Cobb, and Douglas Buildings, and the Olympic Hotel,

including the Metropolitan Theatre, the Olympic Garage and the Cobb Building Annex. (R. 20, 25-26.)

In 1953, the Olympic Hotel and the Metropolitan Theatre, then occupying the entire block on which the Olympic Hotel is situated, were detached from the lease and separately leased to Olympic, Inc. (R. 21, 26.)

On July 18, 1953, a lease (Ex. 3-C) was executed demising the balance of the Metropolitan Tract, including the White-Henry-Stuart, Skinner, Stimson, Cobb, Cobb Annex, and Douglas Buildings, to taxpayer for a term of 35 years from November 1, 1954. (R. 21, 26.) The terms and conditions of this lease agreement are summarized in the opinion of the Tax Court as follows (R. 26-29):

> The term of the lease commenced November 1, 1954, and ends at midnight on October 31, 1989, subject to earlier termination as therein provided. The lease agreed to pay to the lessor as rent for the demised premises a fixed rent in the amount of $1,600,000 for the lease year commencing November 1, 1954, in the amounts of $1,700,000 for the lease years commencing November 1, 1955 and 1956, and in the amount of $1,800,000 for the lease year commencing November 1, 1957. The lessee further agreed to pay a percentage rental for each lease year commencing November 1, 1958, and continuing to the end of the term of the lease, with a minimum guaranteed rental of $1 million per lease year, determined as a percentage of the gross rental income received by the lessee from subtenants for commercial space and a lesser percentage of the gross rental income received by the lessee from subtenants for office space. The percentage rental is not payable on miscellaneous income of the lessee derived from other sources of business activities, such as resale of public utilities, linen and supple services, janitor services, etc. The lease stated that it was understood that all the rentals provided therein were predicated on the assumption that the entire demised premises would be capable of being occupied, operated, or used by the lessee at all times; and if for any reason other than default of the lessee any portion of the demised premises should not be capable of being occupied, operated, or used by the

lessee, the annual minimum guaranteed rental should be reduced for the period of time said space remained untenantable in the amount which would have been the lessor's percentage rental from the untenantable space if said space had been tenantable, and the fixed annual rental should be reduced in a like amount if the situation developed in the first 4 years. The lessee agreed to manage and operate the various buildings on the demised premises as a center of store and office buildings of the first class in the city of Seattle. The lessee also agreed to modernize the buildings on the demised premises and to expend in such modernization at lease $2 million, such modernization program to be commenced promptly upon entering into possession of the demised premises and to be completed if reasonably possible on or before November 1, 1958. The lessor agreed to create a "New Building Fund" and to pay a percentage of the gross rental income it received from the demised premises, limited to a certain amount per year, into the fund, which was to be used to reimburse the lesee for the modernization expenditures heretofore mentioned and for the construction of new buildings and major improvements and additions to the property. The lessee agreed to study from time to time the desirability and economic necessity for the construction of new buildings and capital alterations, and to make recommendations to the lessor with reference thereto. The lessor had the right to determine what buildings and capital improvements would be made, and the lessee was to be responsible for the construction of such buildings and improvements with the right to be reimbursed from the New Building Fund for the cost thereof. The lessee also agreed to expend not less than 4 percent of its gross rental income from the demised premises for maintenance and repair of the buildings and improvements on the demised premises. The lessor was given the right to cancel the lease upon 12 months' notice if at any time during the term of the lease the lessor should become liable for the payment of Federal income tax on all or any part of its income thereunder and the parties should be unable to arrive at a mutually satisfactory modification of the lease terms compensating for such tax liability, in which event the lessor shall pay to the lessee specified sums for each quarterly rental payment that shall have been made under the lease. Upon termination of the lease the lessee shall surrender the demised premises, together with any of the lessee's improvements, fixtures, and any new buildings and capital alterations which may be constructed upon the demised premises during the term of the lease, in as good condition and repaid as when received. Provision was also made for termination of the lease by the lessor in the event of default on the part of the lessee.

On January 29, 1958, the University of Washington reacquired from the United States Government a part of the post office site which had been carved out of the original Metropolitan Tract in 1902. As consideration for this land, the University of Washington agreed with the United States Government through the General Services Administration to demolish the old post office building and to construct a new post office on that part of the site retained by the Federal Government. Certain easements were also exchanged in the transaction. (R. 21, 29.)

On February 5, 1958, a supplemental lease agreement (Ex. 4-D) from the University of Washington to the taxpayer added this newly acquired property to the properties covered by the 1953 lease. (Stip. par. 9, following R. 21; R. 29.) [1/] After reciting execution of the lease agreement of July 18, 1953; its requirement that the taxpayer operate the various structures and buildings then or thereafter constructed upon the demised premises in such a manner as not to injure the reputation thereof and to maintain the demised premises as a center of store and office buildings of the first class and at the same time to so operate the tract as to produce the maximum return consistent with the character of the tract; and that the parties had determined that, in order to accomplish these purposes and to produce a maximum return for the lessor and to preserve and improve the status of the tract as a business enter of the first class, the contemplated new building to replace the existing Douglas Building should be located on its present site enlarged by the addition of the part of the post office tract, described therein, the supplemental lease agreement continued as follows (Ex. 4-D, pp. 2-3):

1/ Page 4 of the stipulation of facts, following R. 21, was omitted i the Tax Court Clerk's pagination of the record as certified to this Co

AND WHEREAS, Article VII, Section 3 of said lease provides that all new buildings upon completion shall be subject in all respect to the rights and obligations of the parties as set forth therein with respect to the original structures upon the demised premises; and

WHEREAS, the Lessor has now acquired the above described tract (being a portion of the present post office site) under and pursuant to a contract designated as GS-RIO-SWPO-A entered into by the Lessor with the General Services Administration of the United States of America..as of October 18, 1957, under which said contract Lessor has undertaken and agreed to demolish the present post office building and to construct a new post office building for the United States of America; and

WHEREAS, Lessor entered into said contract with the General Services Administration of the United States of America upon the understanding and agreement with Lessee that the portion of the present post office site and the rights and privileges in connection therewith to be acquired by the Lessor would be added to and incorporated in the Metropolitan Tract area covered by said lease of July 18, 1953, subject to all of the terms and conditions of said lease, and that in consideration therefor Lesee would undertake to fulfill and perform all of Lessor's undertakings and agreements with respect to the construction of the new post office building for the United States of America.

NOW, THEREFORE, in order to confirm the inclusion of the above described tract within the demised premises and to confirm said understanding and agreement, it is agreed that:

1. The tract of land described above shall be deemed to be a part of the demised premises covered by said lease of July 18, 1953, and any new structure located thereon shall be subject in all respect to the rights and obligations of the parties as set forth in said lease with respect to the original structures upon the demised premises. Without limiting the generality of the foregoing provision relating to the application of the terms of said lease to the tract of land described in this Supplemental Lease and structures thereon, it is specifically agreed that monies in the New Building Fund provided for by Article VII of said lease dated July 18, 1953, may also be expended with respect to the tract of land described in this Supplemental Lease and structures thereon, for the same purposes and in accordance with those same provisions of said lease of July 18, 1953, which govern expenditures out of the New Building Fund with respect to the demised premises, initially described in said lease, and structures thereon.

other consideration, to make three such $80,000 payments "as additional rentals over and above all rentals provided for under the term of" the original lease, which applied to the newly added property in all respects as to the original leasehold. The Commissioner of Internal Revenue disallowed such deductions on the ground that the $80,000 payments "did not represent a current rental payment but a capital expendi[ture] or advance rental not deductible in the year paid," and allowed, instead, a deduction in the nature of an amortization deduction based on prorating such payments over the unexpired term of the original lease at the time the payments were made.

The Commissioner's determination is prima facie correct and the burden was upon the taxpayer to prove that the payments were in fact "rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not or is not taking title or in which he has no equity" within the meaning of the statutory provision on which its claim of eduction is primarily based, or that such payments were in fact "ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business" within the meaning of the statutory provision on which its claim of deduction id secondarily based.

The taxpayer has failed to prove that the payments are deductible under either provision of the applicable statute. It has proved payment of the amounts in issue, and admittedly the taxpayer had not taken and was not taking title to and had not equity in any of the property under lease. It has been judicially determined, however, tha

to be deductible as rent the amount claimed must have been paid as rent in fact, rather than a payment of a different character under the guise of rent. Moreover, such payment must be shown to have been made for the use or possession of the property with respect to the year in which the payment is claimed as a deduction. Payments of advance rental, like payments made to obtain a lease, or payments made by a lessor to procure a lease of his property, are not deductible in full, but must be deducted pro rate over the life of the lease in the form of amortization deductions.

The evidence in this case does not support the taxpayer's contention that the $80,000 "additional rentals" payments made under its supplementary lease constituted rental for the respective years of payment. Rather, the evidence is consistent only with the Commissioner's determination, affirmed by the Tax Court, that the payments were capital expenditures or advance rentals paid as consideration for the inclusion of the additional property in the taxpayer's leasehold.

Likewise, the evidence does not support the taxpayer's contention that the payments in issue represented ordinary and necessary business expenses of the years in which they were made.

ARGUMENT

THE TAX COURT DID NOT ERR IN HOLDING, UNDER THE STIPULATED FACTS, THAT THE ADDITIONAL PAYMENTS OF $80,000 MADE BY THE TAXPAYER IN EACH OF THE TAXABLE YEARS WERE NOT DEDUCTIBLE IN FULL FROM GROSS INCOME IN THE YEAR OF PAYMENT

It is the taxpayer's contention on this appeal that the amount of $80,000 paid by it to the University of Washington on November 1, 1960, and November 1, 1961, respectively, pursuant to the supplemental lease agreement of February 5, 1958, described in the foregoing statement should be allowed in full as a deduction from gross income under Section 162(a) of the Internal Revenue Code of 1954, supra, in the year of payment, either as rent (Br. 10-24), or, alternatively, as ordinary and necessary business expenses (Br. 24-31), in computing its federal income tax liability for the years in issue.

Section 162(a) of the 1954 Code, under which the deductions here in issue are claimed, provides in material part that in computing taxable income there shall be allowed as a deduction from gross income "all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business," including, among other specified expenditures, "(3) rental or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity."

The amounts here in issue were claimed as deductions by the taxpayer on its income tax returns for the years in which the payments were made.(R. 31.) In disallowing the claimed deductions, the Commissioner determined that the payments "did not represent a current rental payment but a capital expenditure or advance rental not deductible in the year paid." On this basis he allowed, instead, as

a deduction for each of the years in issue, in the nature of an amortization allowance, an amount equal to 1/28 of the $80,000 payment made in the fiscal year ended October 31, 1961; and for the fiscal year ended October 31, 1962, he allowed a deduction in the nature of an amortization allowance equal to 1/27 of the payment made in that year. (R. 9, 10.) [2/]

The Tax Court held that the taxpayer had failed to establish its right to the claimed deduction, either as rent (R. 32-35) or as ordinary and necessary business expenses (R. 35-37), and affirmed the Commissioner's determination. We submit there is no error in the Tax Court's decision.

Pertinent in the determination of the issues presented by this appeal are certain established principles of law. It long has been settled, for instance, that the Commissioner's determination of an income tax deficiency "has the support of a presumption of correctness, and the petitioner has the burden of proving it to be wrong." Welch v. Helvering, 290 U.S. 111, 115. See also, Wickwire v. Reinecke, 275 U.S. 101, 105; Matern v. Commissioner, 61 F. 2d 663, 666 (C.A. 9th);

2/ The lease of July 18, 1953, expires by its terms at midnight on October 31, 1989 (Ex. 3-C, p. 3). At the time the first $80,000 payment under the supplemental lease of February 5, 1958, became due on November 1, 1960, the original lease had an unexpired term of 29 years; and at the time the second payment was due on November 1, 1962, the principal lease had an unexpired term of 28 years. In his deficiency notice (R. 9, 10) the Commissioner, without explanation, allowed amortization on the basis of unexpired terms of 28 years and 27 years, respectively, which resulted in slightly larger amortization allowances for each year. If this was an error on the Commissioner's part it results in an advantage to the taxpayer and affords no basis for reversing the Tax Court's decision on the merits. Compare Southwestern Hotel Co. v. United States, 115 F. 2d 686 (C.A. 5th), certiorari denied, 312 U.S. 703.

Todd v. Commissioner, 153 F. 2d 553, 557 (C.A. 9th); Clark v. Commissioner, 266 F. 2d 698, 706 (C.A. 9th), and authorities cited.

It also is settled law that deductions from gross income for federal income tax purposes are allowed as a matter of legislative grace and the burden is upon a taxpayer claiming a deduction to prove facts which will bring his claim clearly within the statutory provision authorizing such deduction. New Colonial Co. v. Helvering, 292 U.S. 435, 440; Deputy v. du Pont, 308 U.S. 488, 493; Interstate Transit Lines v. Commissioner, 319 U.S. 590, 593. Under the most liberal expression of the Supreme Court, "Their extent depends upon the legislative policy expressed in the fair and natural meaning" of the provision authorizing the deduction." Lykes v. United States, 343 U.S. 118, 120.

The federal income tax system is based on annual accounting periods, and while income generally is accounted for in the year it received or accrued and deductions are allowed in the year in which are paid or incurred, according to the method of accounting regularl employed by the taxpayer in keeping his books, these considerations are qualified by the overall requirement that the method adopted must clearly reflect the income. See Sections 441, 446, 451, 461, and corresponding provisions of prior income tax statutes.

The present case is concerned with the time for taking deductio and in United States v. Ludey, 274 U.S. 295, 304, the Supreme Court that a taxpayer "cannot choose the year in which he will take a redut In Burnet v. Thompson Oil & G. Co., 283 U.S. 301, 306, a case involving oil depletion deductions claimed for the taxable year 1918, the Supreme Court reiterated that "in the absence of express provisions to the contrary, it is not to be supposed that the taxpay

is authorized to deduct from that year's income, depreciation, depletion, business losses, or other similar items attributable to other years." In a case somewhat analogous to the present case so far as the issue of law is concerned, this Court said in Lichtenberger-Ferguson Co. v. Welch, 54 F. 2d 570, 571-572: "Under whatever system the taxpayer makes its return, the items of income and deductible expenses must have relation to the business done within the year for which the income tax is paid." See, also, Wells Fargo B. & U. Trust Co. v. Commissioner, 163 F. 2d 521, 524 (C.A. 9th); Commissioner v. Boylston Market Ass'n, 131 F. 2d 966, 968 (C.A. 1st).

The deduction, as a business expense, of amounts paid as rent was first specifically authorized in the case of corporations by Section 12(a), first, of the Revenue Act of 1916, c. 463, 39 Stat. 756, and in the case of individuals by Section 214(a)(1) of the Revenue Act of 1918, c. 18, 40 Stat. 1057, and continued through subsequent Revenue Acts, in language identical with Section 162(a)(3) of the 1954 Code relied upon here. The deduction is limited by this provision to "rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity." Compare Oesterreich v. Commissioner, 226 F. 2d 798 (C.A. 9th). As this Court pointed out in Utter-McKinly Mortuaries v. Commissioner, 225 F. 2d 870, 874:

> The burden imposed by the statute to permit deductions for rentals is onerous. Taxpayer must have proved to the trial court that the payments were wrung from it by compulsion of circumstances delineated by law. The question whether surrounding conditions drove the taxpayer through this narrow gate was surely one of fact.

Mere payment, however, of amounts alleged to be for the continued use or possession of property for purposes of the trade or business is not sufficient to establish deductibility in the year of payment. For instance, the deduction under Section 162(a)(3) is limited to amounts which represent rent in fact. In Utter-McKinley Mortuaries v. Commissioner, supra, a substantial portion of the amounts claimed as deductions for rent paid was disallowed as excessive. In many other situations the courts likwise have held that to be deductible as such, amounts claimed as rental or royalty payments must be such in fact within the limits of the statute. E.g., Le Moyne v. Commissioner, 47 F. 2d 539 (C.A. 7th); Limericks, Inc. v. Commission 165 F. 2d 483 (C.A. 5th); Hightower v. Commissioner, 187 F. 2d 535 (C.A. 5th); W.H. Armston Co. v. Commissioner, 188 F. 2d 531 (C.A. 5th); White v. Fitzpatrick, 193 F. 2d 398 (C.A. 2d), certiorari denied, 343 U.S. 928; Wade Motor Co. v. Commissioner, 241 F. 2d 712 (C.A. 6th); Beus v. Commissioner, 261 F. 2d 176 (C.A. 9th); Midland Ford Tractor Co. v. Commissioner, 277 F. 2d 111 (C.A. 8th); certiorari denied, 364 U.S. 881 West Virginia Northern Railroad Co. v. Commissioner, 282 F. 2d 63 (C.A. 4th); Potter Electric Signal and Manufacturing Co. v. Commissione 286 F. 2d 200 (C.A. 8th); Fairmont Park Raceway, Inc. v. Commissioner, F. 2d 780 (C.A. 7th); Van Zandt v. Commissioner, 341 F. 2d 440 (C.A. 5t certiorari denied, 382 U.S. 814.

Moreover, the courts have held in general, that rental and royalty payments are not necessarily deductible as such for the year in which paid or accrued, but, rather, for the year or years in which they are properly applicable in order clearly to reflect income. The first such case, Galatoire Bros. v. Lines, 23 F. 2d 676 (C.A. 5th), affirming 11 F. 2d 878 (E.D. La.), involved the taxable year 1917. In that case

the taxpayer leased certain business property for a period of 45 months commencing January 1, 1917, and ending September 30, 1920, "for and in consideration of a monthly rental of two hundred and fifty ($250.00) dollars, payable monthly and fifty (50) per cent of the profits of the restaurant conducted in said building during the years 1917, and the obligation on the part of said lessees to board the lessor and his family during the year 1917." 23 F. 2d 676. The lessor's 50% of the profit for 1917 amounted to $16,971.63, and the cost of meals furnished to the lessor and his family during that year amounted to $2,736. Applicable to the payments at issue in the present case is the conclusion of the Court of Appeals in the Galatoire case (23 F. 2d 676-677) that:

> The lease does not purport to make the promise to pay those amounts when ascertained a part of the consideration for the rented premises during the year 1917 only. By the terms of the lease contract the consideration for those payments was, not the use of the premises during 1917 only, but "the present lease," which was for a term of 45 months. In paying those amounts the lessees paid part of the consideration for the use of the premises for 33 months succeeding the year 1917. The expenditures in question being in part a consideration for the use of the rental premises after the year 1917, the whole thereof cannot properly be considered "necessary expenses actually paid in carrying on any business or trade" during that year, and only the part thereof properly attributable to the process of earning income during that year was deductible from the gross income for that year. [Citations.]"

In many other comparable situations the courts have held that rental payments are deductible only for the year in which they are applicable, or over the term of the lease, rather than in the year of payment. In J. Alland & Bro., Inc. v. Commissioner, 1 B.T.A. 631,

and J. Alland & Bro., Inc. v. United States, 28 F. 2d 792 (Mass.), for instance, the Board of Tax Appeals and the District Court of Massachusetts held that advance rental payment made by a cash basis taxpayer under a lease giving it possession of the leased premises o January 1, 1922, were not deductible from 1921 income.

In King Amusement Co. v. Commissioner, 44 F. 2d 709 (C.A. 6th), certiorari denied, 282 U.S. 900, the taxpayer occupied certain premi under a lease for a term expiring 15 years from May 1, 1911. In 1920, in order to obtain an extension of the lease for an additional 10 years it was required to procure responsible parties to guarantee payment of the rent for the extended period. Two of the taxpayer's stockholders undertook to make such guarantee for a fee of $25,000 each. The $50,000 was paid to them and the extension was executed in 1920, nearly 5 years before expiration of the exising lease. The taxpayer claimed the $50,000 as a business expense deduction on its 1920 return on the ground the payment was neither a bonus nor an advance payment of rent. In denying the deduction, the Court of Appeals said in part (p. 710):

> In the case at bar, the petitioner desired to lease the property at a stipulated annual rental agreed upon with the owner. The owner would not make the lease except upon a guaranty of the payment of the rent, and it became necessary for petitioner to pay Finsterwald and King $50,000 to become guarantors. This was neither an "ordinary and necessary expense" nor compensation "for personal services" in carrying on the business, but was an expenditure for an asset which the petitioner could not utilize for nearly five years. It is true that the payment added nothing to the "value of the lease" or "the rental value of the property." It was none the less an expenditure which it was necessary for petitioner to make to acquire property -- a leasehold to use in its business in the future. In our opinion it was a capital investment, subject to annual allowances for exhaustion during the period of the lease. * * *

To the same effect, see Lichtenberger-Ferguson Co. v. Welch, 54 F. 2d 570 (C.A. 9th); Saks & Co. v. Commissioner, 20 B.T.A. 1151.

The principle of these cases has been uniformly applied in case of bonus and advance rental payments such as involved here. 3/ Particularly applicable here because of similarity of the factual situations are Galatoire Bros. v. Lines, 23 F. 2d 676 (C.A. 5th); Baton Coal Co. v. Commissioner, 51 F. 2d 469 (C.A. 3d), certiorari denied, 284 U.S. 674; Home Trust Co. v. Commissioner, 65 F. 2d 532 (C.A. 8th); Main & McKinney Bldg. Co. v. Commissioner, 113 F. 2d 81 (C.A. 5th), certiorari denied, 311 U.S. 688; Southwestern Hotel Co. v. United States, 115 F. 2d 686 (C.A. 5th), certiorari denied, 312 U.S. 703; Wolan v. Commissioner, 184 F. 2d 101 (C.A. 10th); Cooper Foundation v. O'Malley, 221 F. 2d 279 (C.A. 8th); Bloedel's Jewelry, Inc. v. Commissioner, 2 B.T.A. 611; H. Fendrich, Inc. v. Commissioner, 3 B.T.A. 77; Jos. N. Neel Co. v. Commissioner, 22 T.C. 1083; Fitzsimons v. Commissioner, 37 T.C. 179; Williamson v. Commissioner, 37 T.C. 941.

In Baton Coal Co. v. Commissioner, supra, the taxpayer, on November 14, 1926, negotiated a renewal of a lease under which it was operating certain coal properties. The new lease was to run from November 1, 1926 [date of expiration of the old lease], until

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3/ The principle is equally applicable in the converse situation where the lessor spends money or incurs obligations in procuring a lease upon his property, and the expenditure is required to be amortized over the life of the lease. Young v. Commissioner, 59 F. 2d 691 (C.A. 9th); Wells Fargo B. & U. Trust Co. v. Commissioner, 163 F. 2d 521 (C.A. 9th). See also, Bonwit Teller & Co. v. Commissioner, 53 F. 2d 381 (C.A. 2d), certiorari denied, 284 U.S. 690; Central Bank Blcok Ass'n v. Commissioner, 57 F. 2d 5 (C.A. 5th); Griffiths v. Commissioner, 70 F. 2d 946 (C.A. 7th); Commissioner v. Boylston Market Ass'n, 131 F. 2d 966 (C.A. 1st).

all coal had been mined and removed from property covered by the lease. It provided for the payment of $50,000 upon execution and delivery of the lease; for the payment of $51,250 on May 1, 1927; fc payment of a stipulated royalty with a minimum such payment of $26,(annually; for the payment of taxes by the lessee; and for payment tc the lessor of one-half of the net profits of the operation. In rejecting the taxpayer's contention that the payments of $50,000 in 1926 and $51,250 in 1927 constituted deductible expenses in the respective years of payment the Court of Appeals said, in part (51 F. 2d, p. 470):

> It is clear that the payments of $50,000 in 1926 and $51,250 in 1927 did not constitute rental payments for these respective years, but together represented the payment of a bonus or rental in advance for the entire term of the lease, the length of which was determinable by the quantity of coal in the ground divided by the average annual output. The lease was to run until exhaustion of the coal. It is clearly evident, therefore, that those sums, together with the other payments specified in the lease, constituted the consideration for a lease during the entire period, and that, under the law and the regulations, those sums must be apportioned as an expense over the whole term of the lease, and are not deductible as a business expense of the year in which they were paid. [Citations.]

In Main & McKinney Bldg. Co. v. Commissioner, supra, the taxpa in 1926, purchased by assignment a 99-year lease on certain real property expiring in 2024, agreeing to assume all of the obligation under the lease and agreeing in addition, to pay as additional rent the sum of $10,000 a year for the first 25 years after the assignme In denying the deduction in full for those years of the $10,000 additional payments made by the taxpayer in 1934 and 1935 the Court of Appeals said in part (113 F. 2d, pp. 81-82):

> For the purposes of this decision, it is immaterial whether these annual payments were part of the purchase price, or were additional rentals; in either event, these sums, together with the other payments specified, constituted the consideration for a lease over the entire period of ninety-eight years. This lease was executed in consideration of cash paid, together with the payments and obligations specified in article two of the contract. Article two named the sums here in dispute. This court is committed to the doctrine that advance payment of rent, made in consideration of a lease for a longer period of time, have the character of capital investments whose benefits are spread throughout the life of the lease, and only an aliquot part of such expenditure is deductible in any tax year. [Citations.]

Southwestern Hotel Co. v. United States, supra, was a suit for refund of income taxes paid for the fiscal year ended August 31, 1935. Southwestern Hotel Co. v. United States, decided March 23, 1940 (27 A.F.T.R. 968). In that case, the taxpayer, on September 1, 1933, leased certain hotel property for a term of 99 years under an agreement which provided for the payment of graduated monthly rentals, and, as "Additional Money Rentals" the taxpayer agreed to make all payments as they became due on a balance of $424,000 on a note secured by a mortgage on the hotel building. This balance was payable over a period of years which period was shorter than the estimated life of the building, to wit, 33 1/3 years. There became due and payable on this mortgage indebtedness during the taxpayer's fiscal year ended August 31, 1935, the sum of $18,000, which amount was paid under the additional money rental provision of the lease. The Commissioner ruled that the $18,000 should be allocated over the life of the hotel building, 33 1/3 years, and allowed a deduction for the year in issue in the amount of $5,280. The taxpayer sued, claiming the full amount of $18,000 as a deduction, and the District Court sustained the Commissioner's determination. 27 A.F.T.R. 968. On appeal, the Court

of Appeals considered the question to be "whether these payments made in satisfaction of the mortgage debt constituted an ordinary and necessary expense paid or incurred during the taxable year in carrying on the business," within the meaning of the applicable statutory provision, and concluded that determination of this ulitmate question is reached "by deciding whether this payment was rental for the use and occupancy of the premises during the particular year in which it was made, or whether it was an advance payment of rental which exceeded the actual value of the use for the year in which it was paid, and which was made in consideration of a lease for a longer period of time." 115 F. 2d, p. 687. It held that the mortgage payment "were clearly advance payments in contemplation of future benefits accruing during the remainder of the lease," and that they should have been spread over the life of the lease instead of over the shorter period representing the estimated useful life of the mortgaged buildin. 115 F. 2d, p. 688.

Particularly applicable here, also, is the statement of the Court of Appeals in Southwestern Hotel Co. v. United States, supra, p. 688, that:

> The fact that these payments were called "additional rentals" in the lease contract can avail appellant nothing. The character of such payments must be determined in the light of the facts and circumstances surrounding them, and the character, not the name, must control. To hold otherwise would defeat the purpose of the act. If the name controlled the fact, this tax could be avoided by the ignorant by chance misnomer, and by the learned by intentional misnomer.

See, also, Cooper Foundation v. O'Malley, supra, and Home Trust Co. v. Commissioner, supra.

Admittedly, the question whether the payments constitute rental expense, on other ordinary and necessary business expense, within the meaning of the deduction statute, rather than advance rentals or capital investments, depends primarily upon the facts of the particular case. In the instant case, the taxpayer concedes that the basic problem is one "of characterizing the payments here in question as current rental expenses or as capital expenditures; and this characterization is dependent upon the underlying purpose for the payments." (Br. 11.) The only evidence in this case of the "underlying purpose" of the payments here in issue is the brief stipulation of the parties (R. 19-22) and the two lease agreements entered into between the taxpayer and the University of Washington (Exs. 3-C and 4-D). The taxpayer's argument (Br. 10-14) that the payments in issue were current rental payments is based solely on the provisions of paragraph 2 of the supplemental lease agreement of February 5, 1958 (Ex. 4-D, p. 3) and the stipulated fact (R. 22) that the payments were recorded in the rental expense account of the taxpayer's books in the years of payment and were recorded by the University of Washington, a tax exempt organization, as rental income for the years in which received.

Paragraph 2 of the supplemental lease of February 5, 1958, relied upon by the taxpayer, provides as follows:

> 2. Lessee will pay to the Lessor the sum of $80,000.00 on November 1, 1960; the sum of $80,000.00 on November 1, 1961; and the sum of $80,000.00 on November 1, 1962, <u>as additional rentals over and above all rentals provided for under the terms of said lease</u>. (Emphasis supplied.)

The "lease" referred to therein is the lease of July 18, 1953 (Ex. 3-C). The provision does not, contrary to the taxpayer's contention, characterize such payments as current rentals, but as "additional rentals over and above all rentals provided for" under the lease of July 18, 1953,

and the Tax Court quite properly pointed out (R. 32) that if the characterization of the payments in the agreement as "rentals" is accepted, it does not necessarily follow that the taxpayer can deduct the full amount in the years paid. There is nothing in the record to demonstrate that they were intended to be, or were in fact, current rentals rather than advanced rentals.

As the Tax Court pointed out (R. 33), the supplemental lease agreement makes no explanation of why the "additional rentals" were to be paid. Moreover, the taxpayer offered no testimony to explain the purpose of the payments. (R. 35, fn. 1.) Also, contrary to the taxpayer's contention (Br. 12), the taxpayer's treatment of the payments on its books and in its tax returns is not determinative of their purpose or character. If this were so, the Commissioner would be precluded from questioning the correctness of a taxpayer's returns. Compare Oesterreich v. Commissioner, supra.

The authorities cited by the taxpayer (Br. 13-14) are not to the contrary. Hyde Park Realty v. Commissioner, 211 F. 2d 462 (C.A. 2d), cited by the taxpayer (Br. 13), so far as the taxpayer's reliance is concerned, involved an alternative contention, unsupported by the fac[illegible], that advance rentals received by the vendor and credited to the vendee as such upon completion of sale of the property, constituted a reduction of the purchase price rather than rental income to the

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4/ So far as the University of Washington is concerned, if it were a ta[illegible] able organization, it seems clear that such payments would represent [illegible] income when received. Cf. Commissioner v. Lyon, 97 F. 2d 70 (C.A. 9t[illegible]); United States v. Boston & Providence R.R. Corp., 37 F. 2d 670 (C.A. 1t[illegible]); Renwick v. United States, 87 F. 2d 123 (C.A. 7th); Astor Holding Co. [illegible] Commissioner, 135 F. 2d 47 (C.A. 5th); Hirsch Improvement Co. v. Commissioner, 143 F. 2d 912 (C.A. 2d); Gilken Corp. v. Commissioner, 7[illegible] F. 2d 141 (C.A. 6th).

purchaser. One issue involved in Western Contracting Corp. v. Commissioner, 271 F. 2d 694 (C.A. 8th), cited by the taxpayer (Br. 13), was whether the taxpayer was entitled to deduct amounts paid as rentals for certain heavy construction equipment which it first acquired under lease agreements and subsequently purchased at the end of the lease period. In holding that the several lease agreements were not conditional sales agreements, and that the payments in issue constituted rental, the Court of Appeals took into consideration many factors, none of which related to the taxpayer's treatment of the payments on its books. Applicable here, however, is the statement of the Court in Western Contracting Corp. v. Commissioner, supra, p. 699, that "in determining this basic issue, we must look to the intention of the parties and the actual legal effect of the instrument," and cases therein cited.

Benton v. Commissioner, 197 F. 2d 745 (C.A. 5th), cited by the taxpayer (Br. 13-14), is one of the authorities cited in Western Contracting Corp. v. Commissioner, supra, p. 699, and is essentially to the same effect. At issue was the question whether an agreement purporting on its fact to be a lease agreement was, instead, a conditional sales agreement. The Court of Appeals conceived the Tax Court's decision that it was a conditional sales agreement as being based primarily upon objective economic factors rather than upon a determination of the intention of the parties, and on the basis of the Tax Court's own findings the Court of Appeals concluded that the transaction in question was a lease rather than a conditional sale.

The payments here in issue were made pursuant to a supplemental lease agreement, and in the absence of any explanation of their purpose the determination of their character, whether current rental

for possession and use of the demised premises in the year of payment or advance rental paid as part of the consideration for adding the demised premises to the property covered by the original lease, requires a consideration of the terms of the original lease (Ex. 3-C) and the circumstances, as stipulated by the parties (R. 19-22), under which the supplemental lease was executed, as well as the terms of the supplemental lease (Ex. 4-D).

The lease agreement of July 18, 1953 (Ex. 3-C), demised to the taxpayer for a period of 35 years from November 1, 1954, an obviously valuable group of commercial buildings known as the Metropolitan Tract in downtown Seattle. It provided for payment by the taxpayer of annual rental in the respective amounts of $1,600,000, $1,700,000, $1,700,000, and $1,800,000 for the first four years of the lease period, [5/] and a percentage rental for each lease year thereafter equal to specified percentages of the gross rental income received by the taxpayer from subtenants, with a guaranteed minimum rental of $1,000,000 per lease year. The lease further stated that it was understood that all rentals provided therein were predicated on the assumption that the entire demised premises would be capable of being occupied, operated, or used by the taxpayer at all times; and that if for any reason other than default of the taxpayer any portion of th demised premises should not be capable of being occupied, operated, or used by the taxpayer, the annual minimum guaranteed rental should be

5/ As the Tax Court pointed out (R. 35), the fact that the taxpayer paid a fixed annual rental during the first four years of the origina lease has no controlling bearing on the underlying reason for the $80,000 payments here in issue. Moreover, there is no explanation of the reason for fixed annual payments during the first four years of the original lease.

reduced by a proportionate amount for the period of time such space remained untenantable; and the fixed annual rental should be reduced in a like manner of the situation developed in the first four years. (R. 26-27.)

Under the original lease, the taxpayer agreed to modernize the buildings on the demised premises and to expend in such modernization at least $2,000,000, such modernization program to be commenced promptly upon entering into possession of the demised premises and to be completed if reasonably possible on or before November 1, 1958. On the other hand, the lessor agreed to create a "New Building Fund" and to pay a percentage of the gross rental income it received from the demised premises, limited to a certain amount per year, into the fund, which was to be used to reimburse the taxpayer for such modernization expenditures and for the construction of new buildings and major improvements and additions to the property. The taxpayer agreed to study from time to time the desirability and economic necessity for the construction of new buildings and capital alterations, and to make recommendations to the lessor with reference thereto. The lessor had the right to determine what buildings and capital improvements would be made, and the lessee was to be responsible for the construction of such building and improvements with the right to be reimbursed from the New Building Fund for the cost thereof. (R. 27-28.)

On January 29, 1958, the University of Washington reacquired from the United States a part of the post office site which had been carved out of the original Metropolitan Tract in 1902. As consideration for this land, the University agreed to demolish the old post office and to construct a new post office building on that part of the tract retained by the United States. (R. 21.)

The supplemental lease here in issue (Ex. 4-D) was executed February 5, 1958, more than 30 years before the original lease would expire. The most obvious purpose of that agreement was to include th newly acquired post office tract with the properties covered by the original lease. After a number of preliminary recitals, one of which describes the reacquired tract and another of which recites reqcquisi of the tract under a contract which the University agreed to construct a new post office building for the United States, the substanti part of the supplemental lease first provides in paragraph 1 that the described property "shall be deemed to be a part of the demised premi covered by said lease of July 18, 1953, and any new structure locatec thereon shall be subject in all respects to the rights and obligatior of the parties as set forth in said lease with respect to the origin structures upon the demised premises." If further provided that with limiting the generality of the foregoing provision, "it is specifica agreed that monies in the New Building Fund provided for by Article of said lease dated July 18, 1953, may also be expended with respect the tract of land described in this Supplemental Lease and structure thereon, for the same purposes and in accordance with those same provisions of said lease of July 18, 1953, which govern expenditures out of the New Building Fund with respect to the demised premises, initially described in said lease, and structures thereon."

The supplemental lease next provides in paragraph 2, quoted abc for payment by the taxpayer "as additional rentals over and above all rentals provided for under the terms of said lease" of three payments of $80,000 each on November 1, 1960, November 1, 1961, and November 1, 1962.

Paragraph 3 of the supplemental lease then provided that the taxpayer "shall perform and fulfill each and every of the undertakings and agreements of Lessor under or arising out of Lessor's said contract No. GS-R10-SWPO-A with the General Services Administration of the United States of America, and any and all supplemental agreements relating thereto, at a cost to the Lessor not to exceed the sum of $870,000.00." It was further provided that "For such cost, not exceeding the sum of $870,000.00, Lessee shall be reimbursed out of the New Building Fund established by Lessor under the provision of Article VII of said lease dated July 18, 1953. Any excess of such cost over and above the sum of $870,000.00 shall be borne and paid by Lessee."

The concluding paragraph of the supplemental agreement merely provided that "Except as modified herein, all of the terms, conditions and provisions of said lease shall continue in full force and effect."

To support its contention that the $80,000 payments under the supplemental lease were not made as part of the consideration for including the post office tract and New Washington Building in the leased properties, the taxpayer quotes one of the introductory paragraphs of the supplemental lease agreement as stating the consideration for the taxpayer's right to future use and possession of the tract added to the original leasehold. (Br. 11-12.) This and the other preliminary recitals are indicative of the scope and purpose of the supplemental lease, but the consideration for its execution is stated in the substantive provisions of the agreement noted above. The inclusion of the tract in the leasehold estate imposed upon the taxpayer all of the obligations with respect to that tract, including the obligation to pay rent based upon gross rentals received, which

it had assumed under the original lease with respect to the other properties covered by that agreement. In addition, the taxpayer assumed a further obligation under the supplemental lease to make three payments of $80,000 each on November 1, 1960, November 1, 1961, and November 1, 1962, "as additional rentals over and above all rentals provided for under the terms of said lease," and to carry out the University's contract with the United States "at a cost to the Lessor not to exceed the sum of $870,000.00." Presumably that represented the amount of the University's undertaking, and cost of performing this contract was to be paid out of the New Building Fund, which was the property of the University (Ex. 3-C, Art. VII), to the extent of that amount; and only if the cost of performing that contract should exceed $870,000 would the taxpayer incur any financial obligation on that account. When considered in the light of other provisions of the supplemental lease, and other evidence of record, it would seem naive to suggest that the taxpayer's agreement to perform the University's contract with the Government, at the University's expense, represented the only consideration for adding the post office tract and new Washington Building to the taxpayer's le

Moreover, in the absence of any other explanation, the timing of the $80,000 payments, and the fact that only three such payments were required to be made while the tract added to the taxpayer's leasehold would be subject to the original lease agreement for many more years, support the conclusion that the payments represented consideration fo: including the new tract and the new Washington Building in the leaseh There is nothing in the record to associate the payments in issue wit taxpayer's occupancy or use of the added premises during the years of

payment, or to explain their reasonableness as "additional rentals" for the years of payment, or to explain how such "additional rentals" could be justified as rental expense for those particular three years only while the added tract was at all times, including those three years, also subject to the rental provisions of the original lease.

On the other hand, the parties stipulated (Stip. par. 10, between R. 21 and R. 22) that it was decided by the University and the taxpayer that the Douglas Building, smallest and least profitable of the Metropolitan Tract buildings, would be demolished and a new and much larger building constructed on the site. The record does not indicate when this decision was made, or whether it was made incident to reacquiring the post office tract. If the post office tract had not been reacquired, and this decision had been carried out, no additional lump sum rental would have been required under the original lease. It is clear, however, that at the time the post office site was reacquired and at the time the supplemental lease was executed, the parties contemplated a building to occupy both the site of the Douglas Building and the newly reacquired post office tract. The supplemental lease specifically provided that the cost of the new building should be paid out of the New Building Fund. There is no indication in the record as to value of the new Washington Building as an income producing addition to the taxpayer's leasehold estate. It is reasonable to assume, however, that such value was substantial. Likewise, there is nothing in the record to indicate the intention of the parties, at the time the supplemental lease was executed, with respect to when the new building would be constructed. It is reasonable to assume, however, in view of other record evidence, that a timetable for

construction had been agreed upon. Construction of the Washington Building was commenced on July 23, 1958, shortly after the supplement lease was executed on February 5, 1958, and the building was formally opened to occupancy on June 2, 1960, shortly before the first $80,000 payment was due under the supplemental lease on November 1, 1960.

That the three $80,000 payments under the supplemental lease should be timed for the first three years of occupancy of the Washing Building, rather than immediately following execution of the suppleme lease or at some other later period, would not seem to be mere coincidence. Rather, such timing of the "additional rentals" payment seem logically to represent consideration for adding a new and valuab income producing asset to the taxpayer's leasehold estate. 7/ The reacquired post office site and the new Washington Building represent a substantial investment by the University of Washington, which it ha contributed to the taxpayer's leasehold estate, and it would seem justified in demanding some return for the remainder of the lease period over and above the rentals provided in the original lease agreement.

7/ The taxpayer, quoting excerpts from the Tax Court's opinion, argues that "The Tax Court's implied finding that the rent abatement clause was applicable to the transaction in question is clearly erroneous." (Br. 14-15.) The quoted portion of the Tax Court's opin (R. 33-34) cannot be construed as an implied finding. Admittedly, the Tax Court's reasoning is not clear. The so-called rent abatement provision of the original lease (Ex. 3-C, pp. 7-8) may have applied during the period the Douglas Building was untenantable, but there is nothing in that provision to indicate it would apply after the new Washington Building, which replaced the Douglas Building, became tenat able, which was prior to the taxable years here in issue. However, even if the Tax Court's reasoning seems confused, its decision nevertheless must be affirmed if it is correct. Helvering v. Gowran, 302 U.S. 238, 245-246; Riley Co. v. Commissioner, 311 U.S. 55, 59; B.F. Goodrich Co. v. United States, 321 U.S. 126, 127; McDonald v. Commissioner, 323 U.S. 57, 64, fn. 7.

In any event, we submit the taxpayer has failed to meet its burden of proving that the "additional rentals" here in issue were in fact payments for the possession or use of the demised premises for the respective years of payment. The Tax Court's conclusion to the contrary is clearly consistent with the facts and the authorities discussed above.

The taxpayer's attempted distinction (Br. 18-22) of the cases cited in the Tax Court's opinion is without substance. As stated above, the question whether an amount is deductible from gross income as "rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity" within the meaning of Section 162(a)(3) is a question of fact to be determined from the evidence in the particular case. The cases cited in the Tax Court's opinion, despite any factual differences, are pertinent authority for the principles for which they were cited, and those principles are applicable to the facts of the present case.

Nor is there any merit to the taxpayer's contention (Br. 22-24) that this Court's review is not limited by the clearly erroneous rule. Not only is the issue involved essentially one of fact, but the taxpayer has produced no convincing evidence to support its claim, and the record presents no basis for reversal.

Not only is this true with respect to the taxpayer's contention (Br. 10-24) that the payments in issue consituted rent within the meaning of Section 162(a)(3), but it also is true with respect to its further contention (Br. 24-31) that in any event the payments represented ordinary and necessary business expenses within the meaning of

Section 162(a) generally.

It is first contended (Br. 24-26) that in denying deduction of payments as ordinary and necessary business expenses the Tax Court applied "an erroneous standard of deductibility" (Br. 24). The contention is based upon a quoted excerpt (Br. 25) from the Tax Court's opinion (R. 36). In commenting upon the inapplicability of certain cases there relied upon by the taxpayer (R. 35), two of which are again relied upon here (Br. 30-31), the Tax Court said (R. 35-36):

> Those case involved the deductibility as business expenses of losses suffered by taxpayers on the sale of stock or securities they had been obligated to purchase in connection with their everyday business operations. Those cases are not controlling here because we are not concerned with losses, and, furthermore, we have no evidence that petitioner was required to make these $80,000 payments in connection with the everyday operation of its business.

The Tax Court's statement is still pertinent with respect to the applicability of the decisions in Commissioner v. Bagley & Sewall Co 221 F. 2d 944 (C.A. 2d), and Booth Newspapers, Inc. v. United States 303 F. 2d 916 (Ct. Cl.), again relied upon by the taxpayer (Br. 30-3

The so-called "standard of deductibility" is spelled out in the statute. To be deductible under Section 162(a), expenditures must be paid or incurred in carrying on the trade or business of the taxp and they must constitute ordinary and necessary expenses of the busi as distinguished from other types of expenditures, such as capital expenditures. See Welch v. Helvering, 290 U.S. 111; Commissioner v. Tellier, 383 U.S. 687, and authorities cited. The deductibility of expenditures as ordinary and necessary business expenses depends upo the facts of the particular case, and a discussion of the authoritie

would serve no useful purpose here because the taxpayer has presented no evidence which would justify characterizing the $80,000 payments under its supplemental lease as ordinary and necessary business expense within the meaning of the statute.

Relying upon the decision in Wyoming National Bank of Casper, Wyoming v. Commissioner, 23 B.T.A. 408 (Br. 27-28), and quoting excerpts (Br. 28) from the introductory recitals in the supplemental lease as indicative of the motivation for including the post office tract in its leasehold, the taxpayer asserts that its obligation to make the payments in issue existed by virtue of contract in order to "fulfill the obligations set forth in the lease agreement of 1953 and the supplemental lease agreement; i.e., to maintain the character of the originally demised premises as a center of store and office buildings of the first class". This, however, is not sufficient to establish the character of the payments as ordinary and necessary business expenses. The facts in Wyoming National Bank of Casper, Wyoming v. Commissioner, supra, were sufficient to establish the business expense character of payments involved in that case, but here, as the Tax Court said (R. 37); "we have no evidence that would bring petitioner's situation within the ambit of that case."

The Tax Court did not err in denying deduction of the payments in issue as ordinary and necessary business expenses.

CONCLUSION

The decision of the Tax Court is correct. It is supported by the facts and the law and should be affirmed.

Respectfully submitted,

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NOVEMBER, 1966.

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Courts of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Dated: ________________________ day of November, 1966.

Fred E. Youngman

No. 21037

IN THE

United States Court of Appeals For the Ninth Circuit

UNIVERSITY PROPERTIES, INC.,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION TO REVIEW A DECISION OF THE TAX COURT OF THE UNITED STATES

REPLY BRIEF OF PETITIONER

FILED

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IN THE

United States Court of Appeals
For the Ninth Circuit

University Properties, Inc.,
Petitioner,

v.

Commissioner of Internal Revenue,
Respondent.

PETITION TO REVIEW A DECISION OF THE TAX COURT OF THE UNITED STATES

REPLY BRIEF OF PETITIONER

SUMMARY OF ARGUMENT

As shown by the record herein and as discussed in Petitioner's Opening Brief, substantial evidence was presented to the Tax Court supporting petitioner's contention that the payments in question were deductible in full as current rentals.

Petitioner amplifies herein its argument that the mutual treatment by petitioner and its lessor of the payments in question as current rentals in their respective books of account constitute substantial, if not compelling, evidence of their character as current rentals, by citing

additional authority regarding the evidential weight of such book entries.

Respondent's brief, while citing numerous cases, fails to supply a legal basis for the Tax Court's decision. Nor does respondent point to any competent evidence in the record to support the findings and decision of the Tax Court. Mere speculation or conjecture by the respondent, and by the Tax Court, do no furnish a basis for affirming respondent's determination of a deficiency in petitioner's income tax.

ARGUMENT

A. The book entries of petitioner and its lessor are entitled to great weight in determining the character of the payments as current rentals.

The issue raised by the respondent's determination of a deficiency in petitioner's income taxes for the years here in question and presented to this court on appeal relates to the characterization of payments made by petitioner as either rentals, capital expenditures, or advance rentals. The basis for the respondent's disallowance of the deductions claimed by petitioner was that "such amount did not represent a current rental payment but a capital expenditure or advance rental not deductible in the year paid." (R. 9, 10)

Respondent asserts that "the present case is concerned with the time for taking deductions." (Br. 14) and states "The taxpayer paid to the University of Washington in each of the fiscal years ended October 31, 1961 and October 31, 1962, the sum of $80,000 *payable for those years* under the supplemental lease agreement of February 5,

1958." (Emphasis supplied) (Br. 9) Petitioner heartily concurs in these statements and urges reversal of the Tax Court's decision for the reason that there is no substantial evidence in the record to refute them.

Petitioner supports its contention that the payments were current rentals by reference to the supplemental lease agreement (Jt. Ex. 4-D) and the fact that both petitioner and its lessor treated the payments on their respective books of account as current rentals. (R.-22) Petitioner's Opening Brief, pages 10-14, presents the basis for petitioner's claimed deductions of payments as current rentals.

Petitioner's reliance on the mutual construction by petitioner and its lessor of the payments in question as current rentals, as reflected by the book entries of the respective parties, is supported by the following authorities.

In *Sam E. Wilson, Jr.*, 20 T. C. 505, 509 (1953, rev'd on appeal on other issues, 219 F.2d 126) the court stated:

> "Book entries are presumed to be correct unless sufficient evidence is adduced to overcome the presumption."

And it was stated in *Stout v. Commissioner*, 273 F.2d 345, 351 (4th Cir. 1959):

> "Book entries are not necessarily conclusive proof of the facts they represent. When made substantially contemporaneously with the events used long before any tax controversy arises, as these were, they are entitled to great weight. When the conduct of the parties is shown to be consistent with the book entries, there is no justifiable basis for findings in conflict with their disclosure. At least a contrary finding, on this record, cannot be said to rest upon substantial evidence."

In *Gordon v. Commissioner,* 268 F.2d 105 (3rd Cir. 1959), it was determined that in finding contrary to the record entries in the taxpayer's and its supplier's books, "* * * the Tax Court arbitrarily disregarded unchallenged, competent and relevant evidence in the record which was inherently credible." (page 107); and that "* * * the reasons given by the Tax Court for rejecting the uncontroverted evidence of the book entries are wholly without substance." (page 109)

Here also, the book entries of petitioner and its lessor (R.-22), which were consistent with each other and with the parties' agreement (supplemental lease agreement, Jt. Ex. 4-D), treated the payments as rentals accruing in the tax years here involved. The Tax Court relied on no substantial evidence to the contrary and its decision must therefore be reversed.

B. The "presumption of correctness" of the Commissioner's determination was dispelled.

Since the petitioner presented evidence of the characterization of the payments in question as current rentals, any presumption of correctness of the Commissioner's determination otherwise operable disappeared. As was stated by this court in *Clark v. Commissioner,* 266 F.2d 698, 706 (9th Cir. 1959)

> "If the taxpayer introduces evidence from which the determination of the Commissioner contained in a deficiency notice could be found inaccurate then the presumption disappears."

In *Stout v. Commissioner, supra,* the court stated:

> "The presumption of correctness is procedural. It transfers to the taxpayer the burden of going for-

> ward with the evidence, but it disappears in a proceeding to review for assessment when substantial evidence contrary to the Commissioner's finding is introduced. Thereafter, the Tax Court, in such a proceeding, must make its own findings based upon the evidence before it, and we may affirm *only if the findings of the Tax Court are supported by substantial evidence in the record of that proceeding.*" (Emhasis supplied) page 350.

There is no evidence in the record of the Tax Court proceeding, however, that would support a finding that petitioner's payments were advance rents or capital expenditures. As pointed out in petitioner's Opening Brief, the Tax Court's reasons for denying petitioner's deductions were premised upon erroneous factual inferences and on erroneous conceptions of the law relating thereto. (Br. 14-17) As there is no substantial evidence in the record supporting the Tax Court's findings, its decision, therefore, cannot be affirmed.

C. Respondent's cases relating to presumption of correctness and burden of proof are inapplicable.

Respondent cites, without discussion, numerous cases at pages 13 and 14 of its brief relative to the presumption of correctness of the Commissioner's findings and to the burden of proof in a Tax Court proceeding. The cases cited, however, bear no factual similarity to the instant case. It is submitted that the law relative to the above issues is as set forth in the cases discussed in the preceding section of this brief.

D. Cases cited by respondent relative to the time for taking deductions are distinguishable.

At pages 14 and 15 respondent cites numerous cases for the general proposition that a taxpayer cannot deduct

expenses from a given year's income which are attributable to income earned in other years. Again, these cases are cited without discussion in respondent's brief. The proposition stated has validity with respect to the instant case only if the facts here show that the payments in question were attributable to other years. The cases cited by respondent are, without exception, so factually dissimilar from the present case as to supply no authority for the Tax Court's disallowance of the deductions herein claimed. Respondent apparently accorded the case of *Lichtenberger-Ferguson Co. v. Welch*, 54 F.2d 570 (Resp. Br. 15, 19) sufficient weight to have cited it twice in his brief. That case involved a claimed deduction for an advertising expense contracted for in the year prior to the one in which the advertising services were to be rendered. Both the actual payment of the expense and the receipt of the services occurred in a tax year subsequent to the one in which the taxpayer claimed its deduction. In the present case, the additional rentals were paid in the years in which the consideration for the payment was received.

E. Cases cited by respondent for the proposition that the payments here in question were not current rentals do not support that proposition.

The cases cited by respondent at pages 15 to 22 of its brief, few of which were discussed, do not support the decision of the Tax Court in the instant case. To discuss and distinguish each case individually would be an unduly burdensome task and would unnecessarily lengthen this brief, in light of the patent irrelevancy of the great majority of such cases. Briefly, the great majority of the cases cited are distinguishable upon one or more of the

following facts, none of which are present in the instant case.

1. Cases involving close relationship between lessor and lessee, with consequent finding that payments were excessive or not required: *Utter-McKinley Mortuaries v. Commissioner*, 225 F.2d 870 (Resp. Br. 15, 16, 19); *LeMoyne v. Commissioner*, 47 F.2d 539 (Resp. Br. 16); *Limmericks, Inc. v. Commissioner*, 165 F.2d 483 (Resp. Br. 16); *W. H. Armston Co. v. Commissioner*, 188 F.2d 531 (Resp. Br. 16); *White v. Fitzpatrick*, 193 F.2d 398 (Resp. Br. 16); *Wade Motor Co. v. Commissioner*, 241 F.2d 712, 26 T.C. 237 (Resp. Br. 16); *Midland Ford Tractor Co. v. Commissioner*, 277 F.2d 11 (Resp. Br. 16); *Potter Electric & Signal Manufacturing Co., v. Commissioner*, 286 F.2d 200 (Resp. Br. 16); *Fairmont Park Raceway, Inc. v. Commissioner*, 327 F.2d 780 (Resp. Br. 16); *Van Zandt v. Commissioner*, 341 F.2d 440 (Resp. Br. 16).

2. Cases in which the "lessee" acquired an equity in the "leased" property: *Osterreich v. Commissioner*, 226 F.2d 798 (Resp. Br. 15, 19) *Bues v. Commissioner*, 261 F.2d 176 (Resp. Br. 16).

3. Cases involving payments specifically designated by the parties for application to a non-rental account: *West Virginia Northern Railway Co. v Commissioner*, 283 F.2d 63 (Resp. Br. 16); *King Amusement Co. v. Commissioner*, 44 F.2d 709 (Resp. Br. 18); *Saks & Co. v. Commissioner*, 20 BTA 1151 (Resp. Br. 19); *H. Feindrich, Inc. v. Commissioner*, 3 BTA 77 (Resp. Br. 19).

4. Cases involving payments required in first years of

lease term which were grossly disproportionate to those required in other years of the term: *Galatoire Bros. v. Lines*, 23 F.2d 676, affirming 11 F.2d 878 (Resp. Br. 16, 19); *Baton Coal Co. v. Commissioner*, 51 F.2d 469 (Resp. Br. 19, 20); *Main & McKinney Building Co. v. Commissioner*, 113 F.2d 81 (Resp. Br. 19, 20); *Southwestern Hotel Co. v. United States*, 115 F.2d 686 (Resp. Br. 19, 21, 22) *Fitzsimmons v. Commissioner*, 37 T.C. 179 (Resp. Br. 19).

The following cases cited by the respondent are also distinguishable on the facts, and therefore do not constitute authority for the Tax Court's determination in the instant case. *J. Allend & Bros., Inc. v. Commissioner*, cited at pages 17 and 18 of respondent's brief, is clearly distinguishable from the instant case for the reason that a deduction was there sought for payment made in a year in which the taxpayer-lessee had no possession or right to possession of the premises.

In *Home Trust Company v. Commissioner*, 65 F.2d 532 (Resp. Br. 19) there was no contention that the payment in question, made to purchase the interest in a 20-year sub-lease of property of which the taxpayer had become principal lessee under a 99 year lease, was rental. The payment was conceded to be the cost of the acquisition of the sub-lease. There was no question as to the characterization of the payment as current rental.

The issue considered in *Wolan v. Commissioner*, 184 F.2d 101 (Resp. Br. 19) (whether an unamortized portion of advance rentals on the books of a liquidated corporate lessee could be deducted in full by the purchaser of the former lessee's assets in the year of such purchase) bears

no relation whatever to the issues, legal or factual, in the case at bar and for that reason may be disregarded. *Cooper Foundation v. O'Malley*, 221 F.2d 279 (Resp. Br. 19), is likewise distinguishable.

Bloedel's Jewelry, Inc., 2 BTA 611, (Resp. Br. 19), is similar on its facts to *J. Alland & Bros., Inc. v. Commissioner, supra,* in that the question presented was whether monies paid in a tax year prior to the year in which the lessee was entitled to possession of the premises could be deducted in the year of payment. The case of *Williamson v. Commissioner*, 37 T. C. 941 (Resp. Br. 19) is distinguishable for the same reason.

In *Jos. J. Neel Co. v. Commissioner*, 22 T.C. 1083 (Resp. Br. 19) the issue presented was not whether the deduction there sought was a rental payment, but whether the obligation owed by the lessee, which was admittedly an acquisition cost and not a rental obligation, was ratably deductible over the term of the lease. The Commissioner had contended that the obligation was not so deductible, alleging that the obligation to pay was contingent. Thus, neither the facts nor the legal issues there considered bear any relation whatever to the instant case.

F. There is no substantial evidence in the record to support the Tax Court's decision.

Respondent's discussion commencing at page 23 of its brief does not fill the void evidenced by his failure to cite cases of significant factual or legal relevancy. Petitioner's argument for the deductibility of the payments as current rentals is supported not only by provision 2 of the supplemental lease agreement, quoted at page 23 of respondent's brief, but also by the clause of the supple-

mental lease agreement (quoted and discussed in petitioner's Opening Brief at page 12) which clearly and unequivocally states the consideration for the inclusion of the premises added to petitioner's leasehold. The supplemental lease agreement as written and construed by the parties not only negatives the respondent's contention that the payments in question constituted consideration for the inclusion of the post office parcel, but affirmatively establishes that the payments were in fact paid and received as current rentals. It is thus incumbent upon respondent to point to substantial evidence in the record that controverts the evidence supplied by petitioner (see discussion *supra*, pp. 4, 5) Respondent must point to substantial evidence in the record that establishes the payments in question as advance rentals or capital expenditures.

Respondent can cite no evidence whatever to dispel the characterization of the payments as current rentals. Respondent apparently asserts at page 29 of its brief, that the "preliminary recitals" of the supplemental lease agreement, though indicating the scope and purpose of the agreement (which "preliminary recitals" presumably include the statement regarding petitioner's assumption of its lessor's obligation to the United States government to demolish the old Post Office Building and construct a new Post Office Building) were not "substantive" and not expressive of the consideration supplied for the inclusion of the increment to petitioner's leasehold estate. It is naive to suggest that the assumption of this substantial obligation does not constitute contractual consideration. Prior to the execution of the supplemental lease agreement, the petitioner was under no duty to perform its les-

sor's obligations under the agreement with the United States government. The sole responsibility retained by the University of Washington in respect to its agreement with the United States government was to supply funds, to the extent of the $870,000, for the demolition and construction of the new Post Office building. The petitioner was required to pay the cost in excess of $870,000 relating to the said demolition and construction. (Jt. Ex. 4-D, p. 3) It is elementary contract law that the creation of petitioner's contingent liability to pay an amount in excess of the $870,000 would be sufficient consideration for the inclusion of the additional leasehold estate. Moreover, the substantial duties connected with the supervision of the project assumed by petitioner, in addition to the assumption of myriad of other responsibilities, supplied ample consideration.

As a basic premise, it may be stated that a lessor and lessee may agree to a modification of the rents called for under a lease and such modification will not, as a necessary result, require characterization of the modified payments as something other than current rentals. It is only when the modified payments are demonstrably characterizable as something other than payments for current use or occupation of the demised property that capitalization of the modified payments will be required. Circumstances which may lead to such a result, in the absence of contrary evidence, are: the requirement of a grossly disproportionate payment during the first years of a term as compared with payments due in subsequent years; a close relationship between the parties, usually by reason of family or ownership ties; evidence that the "lessee" is in fact acquiring an equity in the property "leased"; or,

a specific agreement by the parties that the payments are to be applied to non-rental accounts. (See cases cited at pages 7-9, *supra*).

Respondent does not contend that the payments here were grossly disproportionate. As indicated by respondent's notice of deficiency, the issue presented is the characterization of the payments as current rental (as contended by petitioner), or advance rentals or acquisition costs (as contended by respondent). (R. 9, 10) There is no suggestion that the payments were excessive, unreasonable, or that the parties here were in collusion to avoid the payment of an income tax. Certainly the parties did not designate the payments as being for something other than current rentals, and it is conceded by the respondent that the petitioner had not taken and was not taking title to and had no equity in any of the property under the lease. (Resp. Br. 10)

Respondent's statement (Br. 24) that the treatment by petitioner and its lessor of the payments on its books and in petitioner's tax returns as current rentals is not determinative of their purpose or character is contrary to the law. See *Stout v. Commissioner; Gorden v. Commissioner* and *Sam E. Wilson, Jr., supra.* Respondent reasons that if such treatment was determinative of the characterization of the payments, the Commissioner would be precluded from questioning the correctness of the taxpayer's returns. (Br. 24) While the treatment is determinative if no contrary evidence is adduced by the Commissioner, the Commissioner is not precluded from adducing such evidence. The Commissioner's problem in the instant case is that he has adduced no evidence to support a contrary determination.

In an apparent attempt to dilute the force of the harmonious treatment of the payments by the petitioner and its lessor, respondent cites authority for the proposition that, as a matter of *tax accounting*, payments, even in the nature of advance rental, may be treated as current income in the hands of the lessor. (Br. 24) The falacy in this reasoning is that the petitioner's lessor is a tax exempt organization and is therefore not required to account pursuant to a fiction created by reason of tax law.

At pages 30-32 of its brief, the respondent alludes to the alleged absence of an explanation for the payments in question and the timing thereof. Hypothetical "reasons" are therein conjured up by the respondent in an attempt to characterize the payments as consideration for the inclusion of the increment to petitioner's leasehold. These "reasons", however, are nothing more than hypothetical possibilities, unsupported by any evidence in the record and, therefore, entitled to no weight whatever.

Respondent at page 31, further faults petitioner for an alleged failure to explain the reasonableness of the payments as additional rentals for the years of payment, or to explain how the additional rentals could be justified as rental expense for the years in question. But the Commissioner's notice of deficiency, and therefore the issues presented in this case, did not include a reference to the "unreasonableness" of the payments in question and this issue is therefore inappropriate and outside the scope of this review. Moreover, in view of the fact that during the years in question petitioner paid nearly two million dollars annually to its lessor as rental (R. 9, 10), the contention that an additional $80,000 per year should be considered "unreasonable" borders on the absurd. See discus-

sion at pages 20 and 21 of petitioner's Opening Brief. Additionally, the cases cited under point 4, pages 7, 8 *supra*, indicate, by negative implication, that in order for a payment otherwise designated as rental to be construed as an advance rental or capital expenditure the payment must be grossly disproportionate to those required during the remainder of the lease term.

Respondent speculates that the Univeristy of Washington would seem justified in demanding "some return for the remainder of the lease period over and above the rentals provided in the original lease agreement." (Br. 32) The answer to this speculation is that the Lease Agreement (Jt. Ex. 3-C, p. 4) provided for payment by petitioner to its lessor of percentage rents, and this provision was adopted by the Supplemental Lease Agreement. (Jt. Ex. 4-D, p. 3) Thus, the parties to said agreement contemplated substantial returns to the lessor over the remaining years of the lease term.

Finally, it is notable that the respondent has failed to make a significant response to petitioner's alternative contention set forth at pages 24-31 of its Opening Brief, that the payments in question were deductible as ordinary and necessary business expense, regardless of their characterization as rentals or non-rentals. The most respondent can muster in response to petitioner's alternative contention is a rather lame repetition of the statements made in respect thereto by the Tax Court, without discussion of the facts or law set forth in petitioner's Opening Brief.

CONCLUSION

Respondent's brief, despite voluminous, excessive and often irrelevant citations of case "authority," totally fails

to answer the issues raised in Petitioner's Opening Brief and to supply a factual or legal basis for the decision of the Tax Court.

In particular, it is evident from the record that petitioner supplied all of the evidence relied upon by the Tax Court, and that such evidence established a *prima facie* case for the deductibility of the payments in question. In the face of such evidence, it was incumbent upon respondent to provide substantial evidence contrary to that adduced by petitioner. Respondent's assumptions and speculations as to the purpose for the payments do not constitute good guesses, much less the substantial evidence required for affirmance of his determination by the Tax Court.

Respondent's failure to present a substantial discussion of petitioner's alternative contention, and his failure to present any discussion of several cases cited by petitioner in its Opening Brief relative thereto, provides strong argument for the deductions claimed by petitioner on that ground.

For the foregoing reasons and for the reasons set forth in Petitioner's Opening Brief, the decision of the Tax Court should be reversed and the payments in question held deductible in full by petitioner.

Respectfully submitted,

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CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with these rules.

DEWITT WILLIAMS
Attorney for Petitioner

NO. 21,075

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

P. UNTALAN, as administrator he Estate of TRINIDAD T. CALVO, ased, and LUIS P. UNTALAN, as llary administrator of the te of ISMAEL T. CALVO, deceased, VICENTA T. CALVO,	)
Appellants	)
vs.	)
M. CALVO, PAUL M. CALVO, as nistrator of the Estate of RDO T. CALVO, deceased, RD M. CALVO, THOMAS J. M. O, VERONICA M. CALVO and RDO T. CALVO,	)
Appellees	)

Brief for Appellants

FILED

OCT 1? 1966

WM. B. LUCK, CLERK

Appeal from Order Civil Case No. 112-65

District Court of Guam

Territory of Guam

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NOV 4 1966

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NO. 21,075

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

UIS P. UNTALAN, as administrator
f the Estate of TRINIDAD T. CALVO,
eceased, and LUIS P. UNTALAN, as
ncillary administrator of the
state of ISMAEL T. CALVO, deceased,
nd VICENTA T. CALVO,

Appellants

vs.

AUL M. CALVO, PAUL M. CALVO, as
dministrator of the Estate of
DUARDO T. CALVO, deceased,
DWARD M. CALVO, THOMAS J. M.
ALVO, VERONICA M. CALVO and
ICARDO T. CALVO,

Appellees

On appeal from the District Court of Guam for the Unincorpor
erritory of Guam.

BRIEF FOR APPELLANTS

JURISDICTION

Jurisdiction of the District Court of Guam is based on 48
.S.C., Section 1424. Jurisdiction of this appeal in this court
s based on 28 U.S.C., Sections 1291 and 1294. The complaint
R1) and amended Count I of complaint (R 14) are the pleadings
hich show the existence of jurisdiction of the District Court
f Guam over this action. The notice of appeal (R 27) is the
leading which shows the existence of the jurisdiction of this
ourt to review the judgment appealed from.

STATEMENT OF THE CASE

A. The facts.

Appellants, Luis P. Untalan, as administrator of the
state of Trinidad T. Calvo, deceased, and Luis P. Untalan, as
ncillary administrator of the Estate of Ismael T. Calvo, deceased
November 8, 1965 filed Complaint for Dissolution of Partner-
ips, for Accounting and Discovery of Assets (R 1) of two partner
ips, viz: (1) Tomas A. Calvo & Sons, composed of Trinidad T.
lvo (now deceased), Eduardo T. Calvo (now deceased) and Ricardo
Calvo (Count I of R 1); and (2) Stud-Pac Motor Company, com-
sed of the three partners comprising the partnership of Tomas
Calvo & Sons, in addition to Ismael T. Calvo (now deceased)
ount II (2) of R 1); or in the alternative, composed of Ismael
Calvo (now deceased), Eduardo T. Calvo (now deceased) and
cardo T. Calvo (Count II (3) of R 1). The amount in controversy
der each count of said complaint exceeded $2,000.00 exclusive
costs and interest (Count I (1)(4) and Count II (1)(8) of R 1).

Appellees filed motion to dismiss said complaint on
nuary 18, 1966 (R 12) because of misjoinder (Paragraph 1 of
12), failure to join indispensable parties (Paragraph 2 of R 12)
d lack of jurisdiction, because claims of said appellants be-
nged in the estates of Eduardo T. Calvo, deceased or Ismael T.
lvo, deceased. The motion was sustained as to Count I of the
mplaint on the ground that indispensable parties were not joined
d denied as to Count II of the complaint (Tr. page 11, lines
to 14, inclusive). Thereupon appellants filed Amended Count I
Complaint for Dissolution of Partnerships, for Accounting and
scovery of Assets (R 14), joining Daniel I. Calvo, Ralph M.

lvo, Bertha A. Toves, Barbara M. Edwards, Thomas G. Calvo, sita C. Calvo and Vicenta T. Calvo as Guardian of the persons d estates of Victor T. Calvo and Mildred R. Calvo, minors, as voluntary plaintiffs (Count I(2) of R 14). Before any of said voluntary plaintiffs filed answers or appeared in this action e trial court scheduled a pre-trial conference for the purposes determining the issues involved (Tr. 14 lines 2 to 7; Tr. 16 nes 1 and 2, 7, 8 & 9, 11 & 12). Appellants objected to the lding of the pre-trial conference before the involuntary plain-ffs had appeared or answered (Tr. 14, lines 20 to 23; Tr. 16 nes 3, 4, 5 & 6). On April 11, 1966 the court entered its etrial Order transferring the action to the Island Court of am for determinations in probate and for the exercise of its obate jurisdiction as a condition precedent to the jurisdiction the District Court (R 21, first paragraph), further ordering:

"1. The above action, Civil No. 112-65, is transferred the Island Court for the consideration of that Court and de-rmination:

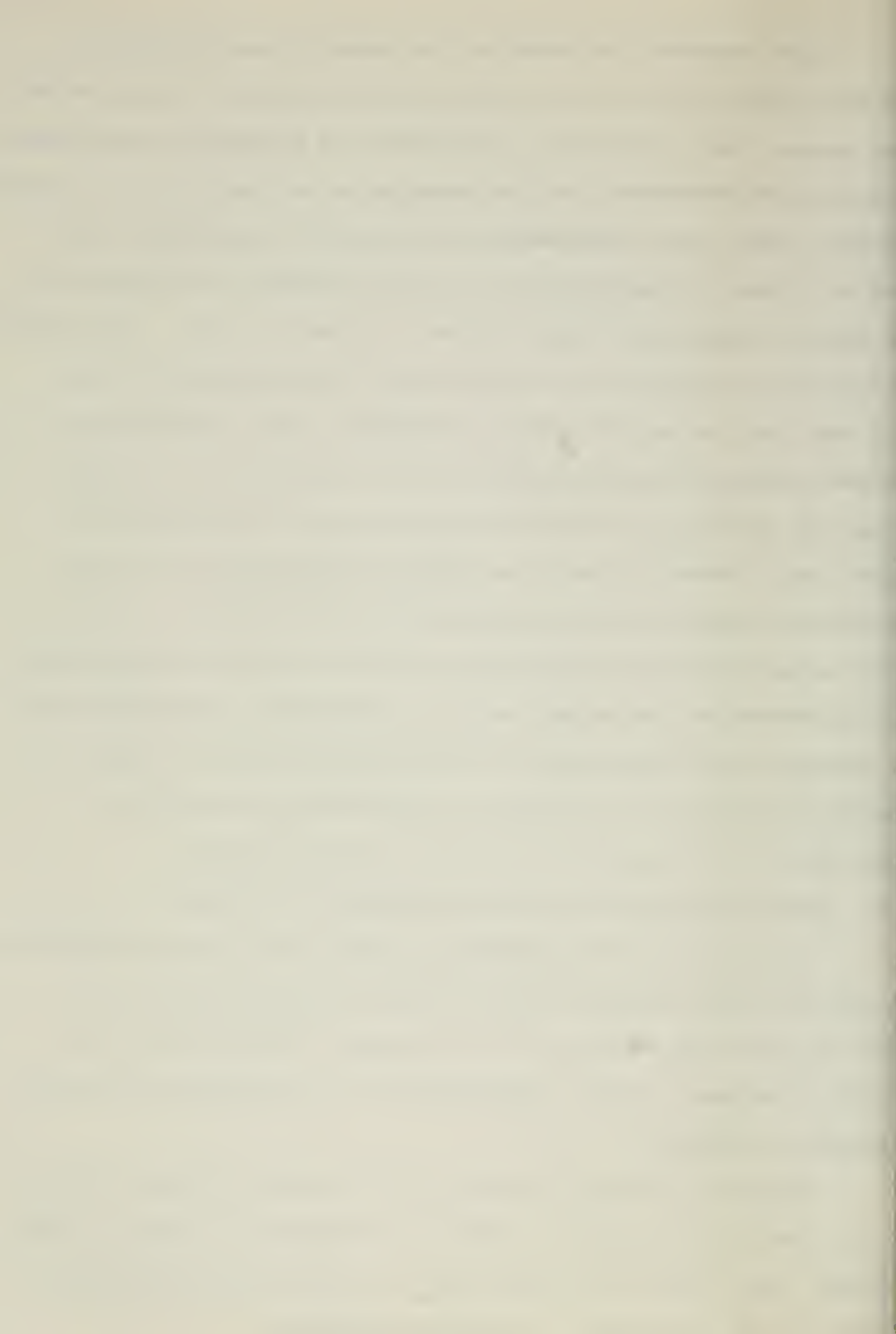
> (a) Whether the Court has jurisdiction within the existing estates to grant any relief properly due.
> (b) Whether the Court wishes to approve litigation on the part of the administrator and permit the administrator to charge the estate with costs of litigation.
> (c) If the Island Court shall determine that the administrator shall be authorized to undertake such litigation and shall approve an action in the District Court, the case may be re-transferred to the District Court as to the Trinidad T. Calvo interest, but the administrator must file a second and different action as to any other estate." (R 21, bottom page 2 and top page 3).

Such transfer was made on the court's own motion at a
-trial conference which was being held to merely determine the
ues before the involuntary plaintiffs had appeared or answered.
court made statements in the pretrial order without any evidenc
support them; said statements are denied by appellants, who
uld be given the opportunity to offer evidence in support of
ir case. Appellants filed Notice of Appeal (R 27). Appellants
e that the District Court of Guam had jurisdiction of this
ion and that it had the duty to exercise said jurisdiction.
cannot legally divest itself of said jurisdiction by trans-
ring the action to an inferior court whose jurisdiction is
ited, said inferior court not having jurisdiction to fully
ermine the controversies contained in said action. It is
ther urged that the Island Court of Guam has no jurisdiction
fully determine the rights of the involuntary plaintiffs who
e joined at the insistence of the District Court of Guam.
tainly the Court is required to adjudicate the rights of
ties which it insisted on bringing into the action.

B. Order transferring action reviewable on appeal.

The order of the District Court of Guam in transferring
s action to the Island Court of Guam for determination in
bate and for the exercise of its probate jurisdiction as a
dition precedent to the jurisdiction of the District Court is
iewable on appeal.

Muller vs. Reagh, 150 C.A. 2d 99; 309 P. 2d 826 holds
t an order of the Superior Court transferring a cause to the
icipal court upon the ground that the superior court lacks
isdiction is appealable. The court stated:



"...It happens that our reviewing courts have upon occasion entertained appeals from orders like the order here involved, notably in these cases: Weaver v. Pasadena Tournament of Roses Assn. (1948), 32 Cal. 2d 833 (198 P.2d 514), affirming a superior court order transferring a cause to a justice's court; Roberts v. Western Pac. R.R. Co. (1951) 104 Cal.App.2d 816 (232 P.2d 560), affirming an order transferring an action from the superior court in San Francisco to the municipal court of San Francisco (petition for a hearing by the Superior Court denied, p. 821). It is true that in neither of these cases do we find a discussion of the appealability of the order. That might mean that such a question did not occur to the court or it may mean that the court considered the appealability of the order too clearly manifest to require comment. We think the latter is the correct view..."

The court pointed out that in the case of Robinson v. Superio urt, 35 Cal. 2d 379, 218 P2d 10 (cited by defendant as authority r the proposition that mandamus was the proper remedy) the trial urt decided that appeal was the proper remedy, although it allow ndamus: "...True, the Supreme Court there entertained mandate en though it decided there was a remedy by appeal. It did so view of the fact that until then there had been no certainty ether or not the order there in question was appealable. It es not follow that whenever there is uncertainty an aggrieved rty must pursue mandate only..."

Said order of the District Court is final and appealable.

) As to the estate of Trinidad T. Calvo (R 14) the District urt has lost control of the action in that it is discretionary th the Island Court as to whether or not the action will be re-ansferred to the District Court (R 21). (2) As to the estate mael T. Calvo (Count II, R 1) the court has completely divested

joinder (R 21, bottom page 2 & top page 3).

ERRORS RELIED UPON

The following are the errors upon which appellants rely:

1. The District Court of Guam had jurisdiction of this ion, was under the duty to try same and was not authorized to nsfer same to the Island Court of Guam.

2. The District Court of Guam erred in finding that ellants, Luis P. Untalan, as administrator of the estate of nidad T. Calvo, deceased, and Luis P. Untalan, as ancillary inistrator of the estate of Ismael T. Calvo, deceased, were empowered to file this action in the District Court of Guam ause said administrators did not obtain the permission of the and Court of Guam to do so.

3. The District Court of Guam erred in finding that jurisdiction was dependent upon the precedent exercise of bate jurisdiction in the Island Court of Guam.

4. The addition of Vicenta T. Calvo as plaintiff and the er parties as involuntary plaintiffs gave the District Court Guam jurisdiction over Count I (R 14) of this action, and re- red said District Court of Guam to adjudicate same.

5. The Court erred in transferring this action to the and Court of Guam before the involuntary plaintiffs were ved with process and allowed to answer in said action.

6. The District Court erred in transferring this action the Island Court of Guam because that court does not have isdiction to settle the accounts of the parties or to afford relief prayed for in the District Court of Guam.

7. The District Court of Guam erred in finding a mis-

mplaint (R 1, Count II) for misjoinder.

ARGUMENT

1. The District Court of Guam had jurisdiction of this action, s under the duty to try same and was not authorized to transfer me to the Island Court of Guam.

Section 62 of the Code of Civil Procedure of Guam reads:

"Original jurisdiction. Under Section 22(a) of e Organic Act of Guam the District Court of Guam has the original risdiction of a district court of the United States in all uses arising under the laws of the United States and has original risdiction in all other causes in Guam except those over which iginal jurisdiction has been transferred to and vested in the land Court of Guam by Section 82 of this title. If it appears at an action or proceeding brought in the District Court is tually within the jurisdiction of the Island Court the District urt shall transfer it to the Island Court for hearing and termination.

Sections82(4) and 82(5) of the Code of Civil Procedure Guam reads:

"4. In all cases at law under the laws of Guam which the demand, exclusive of interest and costs, or the value the property in controversy does not amount to more than $2,000 cept cases which involve the legality of any tax, impost, assess- nt, toll or fine;

"5. In actions for dissolution of partnership, ere the total assets of the partnership do not exceed $2,000;"

It is clear from the above that the District Court of Guam s jurisdiction of the controversies contained in this action, nce the amounts in controversy exceed the sum of $2,000.00, ex- usive of interest and costs, and the original jurisdiction there- has not been transferred to the Island Court of Guam by said ction 82. It is also clear that the District Court of Guam y transfer an action to the Island Court only when the action

ould have been filed in the Island Court of Guam in the first
stance.

Since the District Court of Guam has jurisdiction of this
ion it was under the duty to exercise that jurisdiction and
render a decision therein.

20 Am. Jur.2d 453: "Section 93. Duty to exercise jurisdic-
n. Generally, a court having jurisdiction of a case has not
y the right and the power or authority, but also the duty, to
rcise that jurisdiction, and to render a decision in a case
perly submitted to it. It cannot properly decline to exercise
jurisdiction merely on the ground of the motive or ulterior
pose of the plaintiff in bringing the suit. And state courts
not free to decline the jurisdiction conferred upon them by
gress in cases based on federal statutes if such cases are
hin the scope of the ordinary jurisdiction of the state courts
prescribed by local laws...Failure of a court to adjudicate
its merits a case over which it has jurisdiction may be ground
reversal, on appeal, or its duty to exercise its jurisdiction
be enforced by way of a mandamus proceeding..."

Sampsell vs. Superior Court, 32 C2d 763, 197 P.2d 739 held
t a writ of mandamus should issue to compel the Superior Court
Los Angeles County to hear an application for order awarding
itioner custody of child pending a divorce action. The court
ted: "...Mandamus is available to compel the court to give
ull hearing in the case before it, although it is not available
inform the trial court as to how it should rule with respect
the merits of the case. (Hilmer v. Superior Court, 220 Cal.
73 (29 P2d. 175))..."

"...In the early case of Temple v. Superior Court, 70 Cal.
(11 P. 699), this court held that mandamus should issue to
pel a trial court to hear and determine a proceeding to have
erson adjudged guilty of contempt, although the trial court
dismissed the proceeding 'on the ground of want of jurisdic-
n' because the case came within Code of Civil Procedure section
. The court stated in that case that 'We have examined the

:ord, and are of the opinion that the matter is within the
:isdiction of the court. The facts stated bring the case
:arly within section 1210 of the Code of Civil Procedure, and
ler such circumstances the court cannot, by holding without
ison that it has no jurisdiction of the proceeding, divest
self of jurisdiction, and evade the duty of hearing and de-
:mining it'..."

In State of Indiana ex. rel. Juan S. Lopez v. Alvina M.
.ligrew et al., 174 N.E. 808, 74 A.L.R. 631, the court held that
.ator was entitled to a writ of mandate to compel defendants
allow him to file his verified petition for a writ of error
:am nobis. The court stated: "...When a court has jurisdiction
:r a class of cases and one seeking relief invokes the juris-
:tion of the court in the manner prescribed by law, the parti-
.ar cause is, ipso facto, under the jurisdiction of the court
l the court cannot refuse jurisdiction..."

2. The District Court of Guam erred in finding that appel-
.ts, Luis P. Untalan, as administrator of the estate of Trinidad
Calvo, deceased and Luis P. Untalan, as ancillary administrator
the estate of Ismael T. Calvo, deceased, were not empowered to
e this action in the District Court of Guam, because said
ninistrators did not obtain the permission of the Island Court
Guam to do so.

It is noted that the court made a finding that the permission
the Island Court of Guam was not obtained for filing of com-
.int in this action (R 21 middle page) <u>on its own motion</u> contrary
law as stated in 20 Am. Jur.2d 455 as follows: "Section 94.
:isdiction as dependent on application by party for relief. The
ieral rule is that a court cannot undertake to adjudicate a
itroversy on its own motion; it can do this only when the con-
versy is presented to it by a party, and only if it is presented
it in the form of a proper pleading. A court has no power

ner to investigate facts or to initiate proceedings. Before may act there must be some appropriate application invoking judicial power of the court in respect to the matter sought be litigated..."

No issue as to permission of the Island Court was raised by ellees. Therefore the finding of the court should have no effect

It is well settled that if the acts of an administrator are pursuance of and in accordance with law, he need not secure an er of court to protect him in the discharge of his duties.

21 Am. Jur. 493: "Section 215. Necessity of Court Order for tection.-If the acts of an administrator are in pursuance of, in accordance with law, he need not secure an order of court protect him in the discharge of his duties..."

To the same effect, see re Fulmer, 203 Cal. 693, 265 P. 920, .L.R. 430 in which the court stated: "...That some of the ve-enumerated disbursements may have been made without prior tion of the probate court is not necessarily fatal to their owance. The sums of money paid out of taxes and necessary re-s are such expenses as the administrator must pay in the care management of the estate. People v. Olvera, 43 Cal. 492; Re , 110 Cal. 494, 502, 42 Pac. 971; Re Smith, 118 Cal. 462, 466, Pac. 701. In Re Smith, supra, it is stated to be 'the duty of executor, without special direction of the court, to preserve property of the estate, and he does not require leave of the t so to do, and it is a question how far an order so obtained protect an administrator either in doing or in omitting to do ething which might be deemed important. When the court is so sulted the heirs are not specially cited, but on the settlement the accounts of an executor they are called in and have a right question the acts of the executor and to have an appeal to this t upon any determination which may be made. The previous con-t to the acts of the executor cannot limit their inquiry as to lawfulness of the acts done or the duty of the executor to do which has been omitted. Ordinarily, it would determine the stion of good faith, and quite often that is the only matter

ssion. Still, the failure to obtain it does not render the
penditures made improper. The only result is, that the matter
yet to be passed upon.' Application of this rule disposes of
contention of respondents that the court orders above referred
were void as being made ex parte and without the prior giving
notice. Payments made without a court order are made at the
il of the personal representative (Re Fernandez 119 Cal. 579,
, 51 Pac. 851); but, if the acts of an administrator are in
suance of, and in accordance with, law, he need not necssarily
ure an order of court to protect him in the performance of his
ies (Re Bottoms, 156 Cal. 129, 133, 103 Pac. 849)..."

In Re Bottoms, 156 Cal. 129, 103 Pac. 849, the court held
t an administratrix, whose intestate was a vendee under a
tract for the purchase of land belonging to the estate of the
eased vendor, and who, in his lifetime, had purchased and ob-
ned conveyances from some of the heirs of the vendor of their
erests in the property, is not limited, in order to perfect
title and secure possession of the land for the benefit of
estate of the vendee, to the proceedings to compel a con-
ance of the land provided for by sections 1597 et seq. of the
e of Civil Procedure. If it was to the advantage of the estate
the vendee, she was justified in entering into an arrangement
the direct distribution of the land by the estate of the vendor
the heirs of the vendee, upon payment being made to the estate
the vendor. The fact that such payment was made without per-
sion of the court would not render the expenditure improper,
hough its propriety would be subject to investigation at the
e of the settlement of the accounts of the administratrix of
estate of the vendee.

Unquestionably the administrator of the two estates was
horized to bring this action and he did not have to secure per-

ssion of the court to do so. Certainly the District Court of
am does not have the power, <u>on its own motion</u>, to require such
rmission as a condition precedent to filing this action.

Section 571, Probate Code of Guam: "Duties of executor.
rviving partner. The executor or administrator must take into
 possession all the estate of the decedent, real and personal
 collect all debts due to the decedent or to the estate. When,
 the time of his death, a partnership existed between the de-
dent and any other person, the surviving partner has the right
 continue in possession of the partnership, and to settle its
siness, but the interest of the decedent in the partnership
t be included in the inventory, and be appraised as other
perty. The surviving partner must settle the affairs of the
rtnership without delay, and account to the executor or admin-
rator, and pay over such balances as may from time to time
 payable to him, in right of the decedent. Upon application
 the executor or administrator, the court or a judge thereof,
never it appears necessary, may order the surviving partner
 render an account, and in case of neglect or refusal may, after
ice, compel it by attachment; and the executor or administrator
 maintain against him any action which the decedent could have
ntained."

Section 573, Probate Code of Guam: "Extent of power to sue
 be sued. Actions for the recovery of any property, real or
sonal, or the possession thereof, or to quiet title thereto,
 to determine any adverse claim thereon, and all actions
nded upon contracts, may be maintained by and against executors
 administrators in all cases in which the same might have been
ntained by or against their respective testators or intestates."

11b Cal. Jur. 383, 384: "Section 961. Accounting and
rtnership Suits.- Accounting is a relief incident to other suits
ch may be brought and maintained. The representative by his
eral authority may bring an action for an accounting of moneys
ropriated from the estate, in which action he is the only
essary plaintiff. He may require accounting from or maintain
ion for it against a former representative. Proceedings are
o provided to compel an accounting by persons who have been

rusted with any part of the estate in trust for the executor
administrator.

"The representative in the stead of the decedent may bring
accounting suit against an agent of decedent.

"Suits against surviving partner.- The surviving partner of
decedent is required to present an account to the executor
administrator and pay over any balances due. The representa-
e may maintain against the surviving partner any action which
decedent could have maintained, as well as an action for an
ounting.

"The jurisdiction vested in the probate court does not divest
equity courts of their general jurisdiction over actions of
s character..."

21 Am. Jur. 880: "Section 905. -Equitable Actions.-Usually,
general equitable remedies are available to an executor or
inistrator seeking recovery of assets of the estate or their
ue. Thus, he may file a bill for discovery and accounting,
n where the administration proceedings are being conducted in
ther court, invoke equitable relief against the threatened
lation of a contract of the decedent involving secret manu-
turing processes discovered by the decedent, and compel the
ivery of a written instrument for cancelations in a proper
e..."

Barber v. Superior Court, 43 Cal. App. 221, 184 Pac. 952 holds
t an administrator may, in his own name, for the use and benefit
all parties interested in the estate, maintain a suit for an
ounting against a former administrator; and in such action,
administrator is the only necessary party plaintiff.

3. The District Court of Guam erred in finding that its
isdiction was dependent upon the precedent exercise of Probate
isdiction in the Island Court of Guam.

The Island Court of Guam sitting as a probate court does not
e authority to settle and adjust accounts between a surviving
tner and a representative of the deceased partner. Such juris-

controversy exceeds $2,000.00. The jurisdiction of the Probate
ırt over the estates of deceased persons does not divest the
strict Court of Guam of its general jurisdiction as Court of
ıncery. Sec. 571 Probate Code of Guam, page 12, supra.

20 Cal. Jur.2d 390: "...The probate court has no authority
settle and adjust the accounts between a surviving partner
l the representative of the deceased partner; its power is
ıited to requiring the surviving partner to account..."

Andrade v. Superior Court, 75 C. 459, 17 P. 531 holds that
Probate Court has no authority to settle and adjust accounts
ween the surviving partner and the representative of the de-
sed. The court stated: "...The probate court has no authority
settle and adjust accounts between a surviving partner and the
resentative of a deceased one. Its power is limited to re-
ring the survivor to account...

"...The court cannot settle and adjust the account. If
atisfactory, this can only be done by a court of equity.

"In Theller v. Such, 57 Cal. 447, it was said the 'probate
rt has no more jurisdiction to provide for a partnership
ount and decree a balance, where the partnership has been
solved by the death of a partner, than where it has been
solved by any other cause'...

"...If questions arise in the course of settlement of part-
ship affairs which cannot be adjusted without recourse to the
rts, the probate court is not the forum in which such questions
be solved, but, like other questions cognizable in courts of
ity, they must be determined in the last-named courts..."

The court in Griggs v. Clark, 23 Cal. 427, held that an action
the nature of a suit in equity brought by William T. Clark,
eased, who in his lifetime was in partnership with the defen-
ts, for the settlement of the affairs of a partnership, was
precluded by pending proceedings in the Probate Court. The
rt stated:

"...The defendants demurred to the complaint; the Court be- overruled the same, and this is assigned for error. It is tended, that the Probate Court, in which the proceedings for settlement of the estate were pending, had acquired juris- tion of the subject matter of the present action; and there- e the demurrer should have been sustained. The jurisdiction ted in the Probate Court does not divest the District Courts their general jurisdiction as Courts of Chancery over actions this character, as has been held by this Court. (Wilson v. ch, 4 Cal. 362; Clark v. Perry, 5 Id. 58)."

Section 2431. Civil Code of Guam: "Right to wind up. Un- s otherwise agreed the partners who have not wrongfully dis- ved the partnership or the legal representative of the last viving partner, not bankrupt, has the right to wind up the tnership affairs: Provided, however, that any partner, his al representative, or his assignee, upon cause shown may ob- n winding up by the court."

4. The addition of Vicenta T. Calvo as plaintiff and the er parties as involuntary plaintiffs gave the District Court Guam jurisdiction over Count I (R 14) of this action, and re- red said District Court of Guam to adjudicate same.

Appellees' motion to dismiss the named appellants' complaint 1) because indispensable parties were not joined was granted . page 11, lines 8 to 11) on the theory that the partnership eement (Exhibit A of R 1) conferred rights upon said indis- sable parties which should be adjudicated by the District Court Guam. (Tr. page 2, lines 16 to 26). The validity of that tion of the agreement wherein Trinidad T. Calvo seeks to bequeath assign his share in the partnership (last page Exhibit A of 4) can only be determined by the District Court of Guam - Island Court in Probate has no jurisdiction to pass on the idity of said provision and this action should not have been nsferred to the Island Court sitting in probate for that

nt (Tr. page 2, lines 23 to 26) the indispensable parties are real parties in interest and appellants are out of court if d provision contained in said agreement is valid, which was the more reason for not transferring the action.

5. The Court erred in transferring this action to the Island rt of Guam before the involuntary plaintiffs were served with cess and allowed to answer in said action.

One of the alleged indispensable parties joined as a volun-y plaintiff in this action - the others were joined as involun-y plaintiffs - said involuntary plaintiffs were deprived of ir respective opportunities to be heard by the precipitate trans to the Island Court of Guam, sitting in probate.

Having ordered that said alleged indispensable parties be ned, no action should have been taken by the District Court Guam, detrimental to said alleged indispensable parties before y had entered their appearances in this action.

6. The District Court erred in transferring this action to Island Court of Guam because that court does not have juris-tion to settle the accounts of the parties or to afford the ief prayed for in the District Court of Guam.

(See authorities and arguments under specification of error 3, supra, pages 13 to 15).

7. The District Court erred in finding a misjoinder of ses of action in this action without receiving evidence there-and in effect dismissing Count II of appellants' complaint 1, Count II) for misjoinder.

Appellants alleged (Count II, paragraphs 2 and 3, R 1) that nidad T. Calvo, Ismael T. Calvo, Eduardo T. Calvo and Ricardo

Calvo entered into a partnership agreement under the firm name style of Stud-Pac Motor Company and in the alternative that partnership was composed of Ismael T. Calvo, Eduardo T. Calvo Ricardo T. Calvo. Such alternative pleading is permissible deral Rules of Civil Procedure No. 8(d)(2). On the face of d complaint, therefore, there was no misjoinder. Even if there a misjoinder, the action should not have been dismissed, but uld have been severed and tried separately.

Rule 21, Federal Rules of Civil Procedure: "Misjoinder of ties is not ground for dismissal of an action. Parties may be pped or added by order of the court on motion of any party or its own initiative at any stage of the action and on such terms are just. Any claim against a party may be severed and proded with separately."

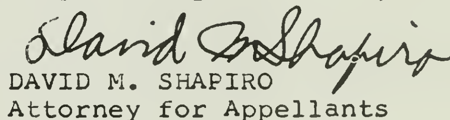
CONCLUSION

For the reasons above stated, it is respectfully submitted t the order appealed from should be reversed.

Dated, Agana, Guam

October 12, 1966

Respectfully submitted,



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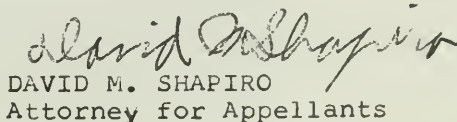
CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this ef, I have examined Rules 18 and 19 of the United States Court Appeals for the Ninth Circuit, and that, in my opinion, the egoing brief is in full compliance with those rules.



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No. 21,075

IN THE

United States Court of Appeals

For the Ninth Circuit

LUIS P. UNTALAN, as administrator of the Estate of Trinidad T. Calvo, deceased, and LUIS P. UNTALAN, as ancillary administrator of the Estate of Ismael T. Calvo, deceased, and VICENTA T. CALVO,
Appellants,

vs.

PAUL M. CALVO, PAUL M. CALVO, as administrator of the Estate of Eduardo T. Calvo, deceased, EDWARD M. CALVO, THOMAS J. M. CALVO, VERONICA M. CALVO and RICARDO T. CALVO,
Appellees.

BRIEF OF APPELLEES

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Appellees.

BRIEF OF APPELLEES

STATEMENT OF THE CASE AND QUESTIONS PRESENTED

This action was commenced by the filing of a most complex complaint, drafted in a quite unorthodox fashion, which complaint on its face stated two causes of action between two separate sets of plaintiffs and two separate sets of defendants, both causes of action

concerning unrelated transactions. Upon motion the complaint was amended, but unfortunately the amended complaint contained all of the same defects noted above. One facet of the complaint indicates laches continuing over a period of years; the other facet demonstrates that the statute of limitations has run.

The trial Court could have made appropriate orders pertaining to this confused complaint but chose instead to require defendants to answer the amended complaint, indicating that the problems complained of by defendants could be ironed out at a pre-trial conference. The pre-trial conference was conducted on April 8, 1966 and the Court entered its pre-trial order, from which plaintiffs now appeal, on April 11, 1966.

Defendants differ with plaintiffs as to the pertinent questions now before this Court. It is defendants' contention that the only question is whether or not, under the law and the Federal Rules of Civil Procedure, the pre-trial order of the District Court of Guam of April 11, 1966 constituted an appealable order as defined in Section 1292, 28 U.S.C.A., or whether it was a final judgment from which an appeal could be taken.

SUMMARY OF ARGUMENT

Plaintiffs have elected to appeal the pre-trial order of the District Court of Guam of April 11, 1966, to this Court. Defendants contend that this appeal cannot lie for the following reasons:

I. The pre-trial order of April 11, 1966 is not an appealable order within the contemplation of Section 1292, Title 28 U.S.C.A.

II. Said pre-trial order is not a final judgment from which an appeal can be taken as contemplated by the Federal Rules of Civil Procedure.

III. Plaintiffs had an appropriate remedy under Rule 54 of the Federal Rules of Civil Procedure to move for judgment upon the pre-trial order if they felt the order was an adjudication of the case on its merits, and under Rule 54(b) of the Federal Rules of Civil Procedure, they could have moved the Court for a judgment of dismissal as to Count II and a certification under the rule permitting appeal.

IV. There was a fatal misjoinder of parties plaintiff and defendant.

ARGUMENT

I.

THE PRE-TRIAL ORDER OF APRIL 11, 1966 IS NOT AN APPEALABLE ORDER WITHIN THE CONTEMPLATION OF SECTION 1292, TITLE 28 U.S.C.A.

Section 1292 states:

> *Interlocutory decisions*
>
> (a) The courts of appeals shall have jurisdiction of appeals from:
>
> (1) Interlocutory orders of the district courts of the United States, the United States District Court for the District of the Canal Zone, the Dis-

trict Court of Guam, and the District Court of the Virgin Islands, or of the judges thereof, granting, continuing, modifying, refusing or dissolving injunctions, or refusing to dissolve or modify injunctions, except where a direct review may be had in the Supreme Court;

(2) Interlocutory orders appointing receivers, or refusing orders to wind up receiverships or to take steps to accomplish the purposes thereof, such as directing sales or other disposals of property;

(3) Interlocutory decrees of such district courts or the judges thereof determining the rights and liabilities of the parties to admiralty cases in which appeals from final decrees are allowed;

(4) Judgments in civil actions for patent infringement which are final except for accounting.

(b) When a district judge, in making in a civil action an order not otherwise appealable under this section, shall be of the opinion that such order involves a controlling question of law as to which there is substantial ground for difference of opinion and that an immediate appeal from the order may materially advance the ultimate termination of the litigation, he shall so state in writing in such order. The Court of Appeals may thereupon, in its discretion, permit an appeal to be taken from such order, if application is made to it within ten days after the entry of the order: *Provided however,* That application for an appeal hereunder shall not stay proceedings in the district court unless the district judge or the Court of Appeals or a judge thereof shall so order.

The relief sought by plaintiffs in their amended complaint does not fall into any of the approved categories mentioned above. On April 11, 1966, the trial Court made its pre-trial order remanding this action to the Island Court of Guam, sitting in Probate, and in its discussion gave most convincing reasons as to why this should be done. Further, the District Court kept the door open in the event the probate Court found that further relief should be sought in the existing action as it pertains to Count I of the amended complaint.

We must remember the hierarchy of the civil Courts of Guam and their interdependence. The jurisdiction of the District Court of Guam as it pertains to this case is set out in Section 1424(a), Title 48 U.S.C.A., as follows:

> *District Court of Guam; jurisdiction; rules of procedure*
>
> (a) There is created a court of record to be designated the "District Court of Guam", and the judicial authority of Guam shall be vested in the District Court of Guam and in such court or courts as may have been or may hereafter be established by the laws of Guam. The District Court of Guam shall have, in all causes arising under the laws of the United States, the jurisdiction of a district court of the United States as such court is defined in section 451 of Title 28, and shall have original jurisdiction in all other causes in Guam, jurisdiction over which has not been transferred by the legislature to other court or courts established by it, and shall have such appellate juris-

diction as the legislature may determine. The jurisdiction of and the procedure in the courts of Guam other than the District Court of Guam shall be prescribed by the laws of Guam.

It is to be noted that the District Court of Guam was given all jurisdiction in Guam except that which the local legislature took away and reserved to inferior Courts created by it. Thus we have these expressions of the Guam Legislature:

> Section 62, *Code of Civil Procedure of Guam. Original jurisdiction.*
>
> Under Section 22(a) of the Organic Act of Guam the District Court of Guam has the original jurisdiction of a district court of the United States in all causes arising under the laws of the United States and has original jurisdiction in all other causes in Guam except those over which original jurisdiction has been transferred to and vested in the Island Court by Section 82 of this title. If it appears that an action or proceeding brought in the District Court is actually within the jurisdiction of the Island Court the District Court shall transfer it to the Island Court for hearing and determination.
>
> Section 82, *Code of Civil Procedure of Guam. Original jurisdiction.*
>
> The Island Court shall have original jurisdiction exclusive of the District Court:
>
> 1. . . .
>
> 2. . . .
>
> 3. In all proceedings under the laws of Guam for the probate of wills, the appointment of ex-

> ecutors, administrators, guardians and trustees, and the administration, settlement and distribution of estates of decedents, minors and missing persons;

In addition, the District Court of Guam sits as the Appellate Court for the Island Court.

In the present case the District Court found jurisdiction to be in the Island Court sitting in probate. Its order called for judicial functions to be performed by the Island Court as a precedence to further action by it. An analogy may be drawn from the opinion of the Court in *Lewis M. Alexander et al. v. The United States of America,* 26 S. Ct. 356, 201 U.S. 117, 50 L. Ed. 686, which states:

> Orders of a Federal Circuit Court directing witnesses to answer the questions put to them, and produce written evidence in their possession, on their examination before a special examiner appointed in a suit brought by the U. S. to enjoin an alleged violation of the anti-trust act of July 2, 1890, (. . .), *lack the finality* requisite to sustain an appeal to the Supreme Court (emphasis supplied).

II.

Even conceding that the District Court of Guam abused its discretion in remanding this case to the probate department of the Island Court, such remand would not have the force of a judgment from which an appeal would lie. Under the Federal Rules of Civil Procedure, pre-trial conference procedure is encouraged in order to simplify issues and expedite case

handling. In *O'Malley v. Chrysler Corporation,* 160 F.2d 35, the Court said:

> Under these rules we think the court has wide discretion and power to advance the cause and simplify the procedure before the cause is presented to the jury. The District Court has the power to issue such orders as in the exercise of sound discretion would advance and simplify the cause before trial. If it abuses that discretion in making such orders it is conceded that no appeal would lie under Section 128 and there would be nothing final about such orders. In our opinion the order made in the instant case was such an order. It was only a step in the *orderly procedure* of the case (emphasis supplied). The District Court was exercising its pre-trial powers. It would, in our opinion, have had the *power* to make the order it made irrespective of the Federal Rules of Civil Procedure.

Again, analogies can be drawn. In the case of *Latta v. Kilbourn,* 150 U.S. 524, the Court entered a decree on an accounting action determining the rights of the parties and referring the case to an auditor in order that an account might be stated upon which a further decree could be entered. The Court above held that this was not a final appealable decree in the language following:

> It is first contended on behalf of the appellees that this appeal cannot be entertained by this court for reason that the decree of October 27, 1886 was the final decree in the cause from which an appeal should have been taken. We are clearly of the opinion that this position cannot be sustained. It is well settled by the decisions of this

> court that where the purpose of the suit is to attain an account, such as that prayed for by the bill in this case and directed by the order of October 27, 1886, the decree is of such an interlocutory character that no appeal will lie therefrom . . .

In the *Latta* case, above, the Court also referred to *McGourkey v. Railway Company,* 146 U.S. 544, wherein the authorities are thoroughly reviewed as to what constitutes a final decree. It was stated therein that as a general rule, if the Court makes a decree fixing the rights and liabilities of the parties and thereupon refers the case to a master for a ministerial purpose only, and no further proceedings in Court are contemplated, the decree is final; but if the case is referred to the master for a judicial purpose, as to set an account between the parties upon which a further decree is to be entered, then the decree is not final.

A further clear expression of the point is in *Karl Kiefer Machinery Co. v. U. S. Bottlers Machinery Co.,* 108 F.2d 469:

> The words "final decisions" mean the same thing as "final judgments and decrees." A final decree or judgment is one that puts an end to the controversy between the parties litigant. *Merriman v. Chicago & E.I.R. Co.,* 64 F. 535.

And, in *United States Sugar Corporation v. A.C.L. Railway Co.,* 196 F.2d 1015, the Court stated:

> Only "final decisions" are reviewable. A judgment is "final" for purposes of appeal only when it

determines the litigation on the merits, leaving nothing to be done but to enforce the judgment. *Lewis v. E.I. DuPont DeNemours & Co.,* 183 F.2d 29, 21 A.L.R. 2d 757. The order appealed from does not terminate the litigation, but allows defendant to plead further. It grants no relief to the plaintiff nor any against the defendant. There were other issues of fact in the case that had to be determined before final judgment can be entered. The order is clearly interlocutory, not a final decision, and is therefore not appealable.

Finally:

A judgment which does not dispose of all the issues, but which is but a step toward a final hearing and decision, is not appealable (*Arnold v. Guimarin,* 263 U.S. 427, 68 L.Ed. 371, 44 S.Ct. 144; *Rexford v. Brunswick-Balke-Collender Co.,* 228 U.S. 339, 57 L.Ed. 864, 33 S.Ct. 515,) as where it leaves undetermined matters within the pleadings and retains the cause for the purpose of thereafter passing upon them and for the entry of a further judgment. (*City of Paducah, Kentucky v. East Tennessee Tel. Co.,* 229 U.S. 476, 57 L. Ed. 1286, 33 S.Ct. 816.) If the decision or judgment leaves some matter involved in the controversy open for future hearing and determination before the ultimate rights of the parties are conclusively adjudicated, it is interlocutory and not final. (*Smith v. Benedict,* 279 F.2d 211; *School Dist. No. 5 v. Lundgren,* 259 F.2d 101; *Phelan v. Middle States Oil Corp.,* 210 F.2d 360.) The principle has been laid down that, where the court has power to further review its judgment, the judgment is not final so long as it is being considered by the court. (*Suggs v. Mutual Benefit Health &*

Accident Ass'n, 115 F.2d 80.) It makes no difference whether the attention of the court is directed to a further consideration of its judgment by a pleading filed as a matter of right, or by a pleading which has no standing in the case as a matter of law, or springs from the court itself. The fact that the court expresses an intent to further consider the judgment prevents its finality. (*Suggs v. Mutual Benefit Health & Accident Ass'n,* 115 F.2d 80.) Cyc. Fed. Proc. 3d 13, Rev. Judgm'ts, § 57.20, pp. 118-119.

III.

It is elementary that federal policy is against piecemeal appeals. However, in the event that a party feels aggrieved as did plaintiffs here, at the trial Court's ruling in its pre-trial order, said aggrieved party is under the obligation to take certain interim steps to determine whether appeal will lie at the interim stage of proceedings. To this end, plaintiffs, instead of pursuing an appeal from the pre-trial order, should have moved the trial Court for entry of judgment based upon the pre-trial order, or any part of it that they considered to be a final determination. This is especially true in view of plaintiffs herein having determined themselves that Count II of the amended complaint had been dismissed by the pre-trial order. Rule 54(b) required plaintiffs to seek a certification from the trial judge and the failure to do so makes this appeal premature, even if it could lie for other reasons. Where an appeal has been taken prematurely and no attempt is made to correct the initial fatal deficiency, the deficiency will not correct itself. This

is demonstrated by the recent case in this circuit, upon appeal from Guam, of *Maddox v. Black, Raber-Kief & Associates,* 303 F.2d 910. In that case the District Court of Guam made an order on June 9, 1961. Further proceedings were had toward a new trial and vacation of judgment, but actually findings of fact, conclusions of law and judgment were not filed until June 22, 1961. Subsequently, appellants, on August 25, 1961, filed its notice of appeal "from the judgment entered in this action on June 8, 1961. . . ." This was the only notice of appeal given in this case and this Court found it insufficient. If appellants, in the instant case, for any reason, had any right of appeal based on the pre-trial order of April 11, 1966, they failed to perfect those rights.

IV.

The trial Court found in its pre-trial order that there had been a misjoinder of parties and causes of action, which appellant parties agreed with in their brief (Appellants' Brief, p. 16, para. 7). However, appellants have missed the point that not only did they have a misjoinder of parties, both plaintiff and defendant, but that they also had a misjoinder of causes of action. It is to be noted that Rule 21 of the Federal Rules of Civil Procedure permits the dropping of parties or the severance of claims. In essence, the trial Court attempted to clear up the situation at least partly in its pre-trial order by dismissing Count II of the amended complaint and advising appellants that that count would have to be filed as a separate complaint at such time as it again came before this

Court. While the rules generally have been slanted to make it easier for Courts to cure misjoinder of parties or causes and to separate them, there are still instances such as this where the misjoinder is so complete that one or another set of litigants will be required to start over. This is well illustrated by the case of *Erwin v. City of Dallas,* 85 F.Supp. 103, which was a case wherein plaintiffs sought to restrain the city from refusing to grant beer licenses to the plaintiffs. The Court found that there was a misjoinder of parties plaintiff where there was no relationship whatsoever between them, they were separate individuals, and they were not connected in any way in business; and where the place of business of one was not in the neighborhood of that of either of the others; and where the facts were quite different.

CONCLUSION

For the reasons above stated, it is respectfully submitted that the pre-trial order of April 11, 1966 should stand, and that appellants should be required to conform thereto.

Dated, Agana, Guam,
January 5, 1967.

Respectfully submitted,
E. R. Crain,
Attorney for Appellees.

Certificate of Counsel

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

E. R. Crain,
Attorney for Appellees.

NO. 21,075

IN THE

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

. UNTALAN, as administrator Estate of TRINIDAD T. CALVO, ed, and LUIS P. UNTALAN, as ary administrator of the of ISMAEL T. CALVO, deceased, CENTA T. CALVO, Appellants vs. . CALVO, PAUL M. CALVO as strator of the Estate of T. CALVO, deceased, M. CALVO, THOMAS J. M. CALVO, CA M. CALVO and RICARDO T. CALVO, Appellees	APPELLANTS' REPLY BRIEF

FILED

JAN 30 1967

WM. B. LUCK, CLERK

Appeal from Order Civil Case No. 112-65

District Court of Guam

Territory of Guam

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FEB 15 1967

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NO. 21,075

IN THE

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

P. UNTALAN, as administrator he Estate of TRINIDAD T. CALVO, ased, and LUIS P. UNTALAN, as llary administrator of the te of ISMAEL T. CALVO, deceased, VICENTA T. CALVO, Appellants vs. M. CALVO, PAUL M. CALVO as nistrator of the Estate of RDO T. CALVO, deceased, RD M. CALVO, THOMAS J. M. CALVO, NICA M. CALVO and RICARDO T. CALVO, Appellees	APPELLANTS' REPLY BRIEF

ARGUMENT

The only question raised by appellees in their brief is whether ot the order of the District Court of Guam (contained in Pre- l Order of April 11, 1966) transferring this action to the nd Court of Guam, is appealable (Brief of Appellees, page 2). propriety of the District Court's action is not argued, except some reference is made to misjoinder of parties plaintiff and ndant. (Brief of Appellees, pages 3, 12 and 13). Appellees do not justify the District Court's action (or claim that District Court acted properly) in transferring this action to Island Court of Guam. The inference can be drawn, therefore, if the said order is appealable the District Court acted

roperly in making said order and same should be reversed.

The authorities cited by appellees are not in point. These horities simply state (which appellants concede) that interlocuy orders are not appealable and that as long as the trial court control of the action and has not finally disposed of same, no erim orders are appealable. Appellees have not cited a single holding that an order such as the one appealed from, is not ealable. They have not questioned Muller vs. Reagh, 150 C.A. 99; 309 P 2d 285, which holds that an order of the Superior Court nsferring a cause to the Municipal Court is appealable and have ed no case holding to the contrary.

The order appealed from is final because the District Court uam has divested itself of jurisdiction - it no longer has rol of the action - it does not have the right to try the action ts merits - it has taken its final action - nothing more remains it to do. The order is therefore final and appealable.

Appellants' appeal is taken under 28 U.S.C., Section 1291, viz:

> "1291. Final Decisions of District Courts. The courts of appeals shall have jurisdiction of appeals from all final decisions of ... the District Court of Guam..."

eOrder appealed from is final and appealable. (Muller vs. Reagh, pa).

28 U.S.C., Section 1292 concerns "interlocutory decisions" and herefore inapplicable.

Rule 54, Federal Rules of Civil Procedure (Appellees' Brief, g 3) is not in point, as the District Court of Guam divested

lf of jurisdiction to try the action on its merits.

The trial court was not authorized to find a misjoinder of ies and causes of action without submitting these issues for l. As shown by the pleadings the question of misjoinder was sputed question of fact and could not be decided by the court out the submission of evidence. Furthermore, misjoinder is ground for dismissal. Rule 21, Federal Rules of Civil Procedure ellants' Brief, page 17).

Appellants repeat that the authorities cited by appellees are erned with interlocutory decisions only, which admittedly are appealable. The order appealed from in this action is final appealable. The court erred in making said Order.

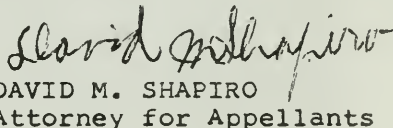
CONCLUSION

For the reasons above stated, it is respectfully submitted that order appealed from should be reversed.

Dated, Agana, Guam

January 24, 1967

Respectfully submitted,



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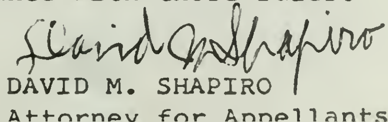
CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this f, I have examined Rules 18 and 19 of the United States Court ppeals for the Ninth Circuit, and that, in my opinion, the going brief is in full compliance with those rules.



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No. 21080

United States
COURT OF APPEALS
for the Ninth Circuit

PACIFIC INLAND NAVIGATION COMPANY, a corporation,

Appellant-Cross-Appellee.

v.

DELBERT A. COURSE,

Appellee-Cross Appellant

Appeal from the United States District Court
For the District of Oregon

HONORABLE JOHN F. KILKENNY

BRIEF OF APPELLANT

FILED
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No. 21080

United States
COURT OF APPEALS
for the Ninth Circuit

PACIFIC INLAND NAVIGATION COMPANY,
a corporation,

Appellant-Cross-Appellee.

v.

DELBERT A. COURSE,

Appellee-Cross Appellant

Appeal from the United States District Court
For the District of Oregon

HONORABLE JOHN F. KILKENNY

BRIEF OF APPELLANT

JURISDICTION

The vessel was on navigable waters of the United States. Being a maritime injury, the District Court on the Admiralty side had jurisdiction to hear the cause under Sec. 2 of Article III of the United States Constitution, and Title 28, U. S. C., Sec. 1333 (1). The jurisdiction of this Court to review the District Court's decision is based upon Section 1291 of Title 28 U.S.C., this appeal having been taken from a final decree entered on December 20, 1965.

STATEMENT OF THE CASE

This action involves a Libel in Personam for dam-

ages for unseaworthiness of the tug "BANNOCK" instituted by a ship repairman-marine electrician, Delbert A. Course, appellee, against his employer-shipowner, Pacific Inland Navigation Company, appellant. It arose from a shipboard accident on December 19, 1963, at Vancouver, Washington, when appellee fell through a hatchway while en route from the vessel to the repair yard for a shoreside purpose. (Findings of Fact and Conclusions of Law). The tug "BANNOCK" was wholly owned and operated by appellant. Appellant maintained a ship repair yard at Vancouver, Washington, for the sole purpose of repairing its own vessels. Appellee was employed as a marine electrician and had been in appellant's repair yard for more than one year prior to his injury. At all times appellee was under the supervision and control of appellant's repair yard supervisory personnel. At the time of appellee's injury the vessel was undergoing certain repairs and was solely under the control of appellant's ship repair personnel.

Appellee received from appellant the statutory benefits of the Longshoremen's and Harbor Workers' Compensation Act, 33 U.S.C. 901-950, inc.

The trial resulted in a verdict in favor of appellee in the amount of $12,566.08.

In the Pretrial Order and by a separate pretrial motion, appellant sought a dismissal of the action on the ground that appellee, having received his statutory entitlements from his employer, was precluded from maintaining this action. The District Court denied appellant's motion upon the authority of the case of *Reed* v.

SS YAKA, 373 U.S. 410 (Findings of Fact and Conclusions of Law). Appellant in the Pretrial Order and by post trial motions raised the defenses that at the time of appellee's injury he was not engaged in work traditionally performed by a seaman and was therefore not entitled to the warranty of seaworthiness; and that at the time when appellee was injured the vessel was a dead ship and was out of navigation and therefore did not warrant her seaworthiness. Both of these defenses were denied by the District Court (Findings of Fact and Conclusions of Law).

SPECIFICATIONS OF ERROR

1. The District Court erred in denying appellant's Motion for Summary Judgment, because appellee is not entitled to bring a cause of action against his shipowner-employer under the authority of *Reed* v. *SS YAKA, supra.*

2. The District Court erred in holding that the tug "BANNOCK" was not a "dead" ship and that she was in "navigation."

3. The District Court erred in holding that appellee was entitled to the warranty of seaworthiness, although he was at the time of his injury engaged in a shoreside activity.

SUMMARY OF ARGUMENT

1. The provisions of the Longshoremen's and Harbor Workers' Compensation Act immunize a shipowner-em-

ployer from an action for unseaworthiness by his employee and the maintenance of such an action would conflict with the economic standards of the Act and produce a harsh and incongruous result.

2. The holding of *Reed* v. *SS YAKA, supra,* even if valid in its factual framework of that case, is inapplicable to the case at bar because appellant shipowner owned and operated the tug "BANNOCK" and no third party was involved.

3. The rationale employed by the Supreme Court in deciding that Reed should be accorded the same protection whether he sustained injury while employed by a stevedore or directly by a shipowner is not applicable to appellee because appellee was in the appellant's steady employ and is not a longshoreman.

4. A vessel under the control of a ship repairer, with her main engines dismantled, is a dead ship and out of maritime service, and does not warrant her seaworthiness.

5. A ship repairman who at the time of his injury is not engaged in work traditionally performed by a seaman is not entitled to the warranty of seaworthiness.

ARGUMENT

The Longshoremen's and Harbor Workers' Compensation Act Precludes Maintenance of Action.

> "Like other workmen's compensation laws the Longshoremen's and other Harbor Workers' Compensation Act involves a relinquishment of certain legal rights by employees in return for similar sur-

> render of rights by employers. Employees are assured hospital and medical care and subsistence during convalescence. Employers are assured that regardless of fault their liability to an injured workman is limited under the Act. In some instances injury to an employee is caused by a third party. In such circumstances, Sec. 33 of the Act reserves to the employee the right to seek damages against the third party." U. S. Code Congressional and Administrative News, Vol. 2, page 2134, Senate Report No. 48.

The employer immunity provision of the Act is found in 33 U.S.C. § 905:

> "Exclusiveness of Liability. Sec. 5. The liability of an employer prescribed in Sec. 4 shall be exclusive and in place of all other liability of such employer to the employee, his legal representative, husband or wife, parents, dependents, next of kin, and anyone otherwise entitled to recover damages from such employer at law or in admiralty on account of such injury or death, except that if an employer fails to secure payment of compensation as required by this Chapter, an injured employee, or his legal representative in case death results from the injury, may elect to claim compensation under this Chapter or to maintain an action at law, or in admiralty for damages on account of such injury or death."

In some cases injury to an employee is caused by a third party. In such cases the Act preserves to the employee the right to seek damages against a third party. This provision of the Act is found in 33 U.S.C. § 933 (a):

> "Compensation for Injuries Where Third Persons are Liable Sub Sec. (a) If on account of a disability or death for which compensation is pay-

able under this Chapter the person entitled to such compensation determines that some person other than the employer or a person or persons in his employ is liable in damages, he need not elect whether to receive such compensation or to recover damages against such third person."

The complete immunization of the employer (with one exception hereinafter noted) from personal injury actions brought by an employee has long been recognized by the Supreme Court in the following cases:

Nogueira v. *N.Y.N.H. and H.R. Co.,* 281 US 128 (1929).
South Chicago Co. v. *Bassett,* 309 U.S. 251 (1940).
Swanson v. *Marrah Bros.,* 328 U.S. 1 (1945).
Ryan v. *Pan-Atlantic S.S. Corp.,* 350 U.S. 124 (1956).

In the recent case of *Ryan* v. *Pan-Atlantic SS Corp.,* 350 U.S. 124 (1956), the Court stated at page 129:

"The obvious purpose of this provision is to make the statutory liability of an employer to contribute to its employee's compensation the exclusive liability of *such employer to its employee,* or *to anyone* claiming under or through such employee *on account of his injury or death arising out of that employment.* In return the employee and those claiming under or through him are given a substantial *quid pro quo* in the form of an assured compensation, regardless of fault, as a substitute for their excluded claims. . . . Therefore, in the instant case, it excludes the liability of the stevedoring contractor to its longshoreman and to his kin, for damages on account of the longshoreman's injuries. At the same time, however, Sec. 5 expressly preserves to each employee a right to recover damages against third persons."

In the dissenting opinion of the *Ryan* case, *supra,* Justice Black, the author of the majority opinion in *Reed* v. *SS YAKA, supra,* stated at page 140:

> "And while Congress imposed absolute liability on employers they were also accorded counter-balancing advantages. They were no longer to be subjected to the hazards of large tort verdicts. Under no circumstances were they to be held liable to their own employees for more than the compensation clearly fixed in the Act."

As previously mentioned there is an exception to the exclusive immunity doctrine which arises from the voluntary assumption of obligations by the employer running to the vesselowner, which have given rise to numerous indemnity suits by the vesselowner against the employer. This exception is well illustrated in the language of *Ryan* v. *Pan-Atlantic SS Corp., supra,* at page 131:

> "While the Compensation Act protects a stevedoring contractor from actions brought against it by its employee on account of the contractor's tortious conduct causing injury to the employee, the contractor has no logical ground for relief from the full consequences of its independent contractual obligation, voluntarily assumed to the shipowner, to load the cargo properly. . . .
>
> "The Shipowner's action here is not founded upon a tort or upon any duty which the stevedoring contractor owes to its employee. The third-party complaint is grounded upon the contractor's breach of its purely consensual obligation *owing to the shipowner* to stow the cargo in a reasonably safe manner. Accordingly, the shipowner's action for in-

demnity on that basis is not barred by the Compensation Act."

The case of *Smith* v. *The MORMACDALE,* 198 F.2d 849, 3 Cir., (1952) cert. den. presents the same factual situation as the case at bar, with the exception that Smith filed an *in rem* action whereas Course filed *in personam.* It was there held that where a ship is owned by the employer, the exclusive provisions of the Longshoreman's Act controls, saying at page 850:

> "To impose this additional liability on the employer where he is also the shipowner would radically distort the intent of Congress in enacting the Longshoremen's Act. . . .
>
> "The identical point argued here was raised in *Samuels* v. *Munson SS Line, supra,* in a well-reasoned opinion that court pointed out the absurd results which would arise if a longshoreman were permitted to accomplish what is here attempted. We agree with the reasoning and the result of that opinion."

These decisions have never been overruled by the Supreme Court either before or after the case of *Reed* v. *SS YAKA, supra.* Consequently, the Court is compelled to make the same holding, namely, that a shipowner-employer may not be sued for damages by an employee because of the exclusive provisions of the Act.

Reed v. SS YAKA, a Third Party Case

We are now brought to an analysis of the case of *Reed* v. *SS YAKA,* and to distinguish its unique facts from those at bar. In reading *Reed* v. *SS YAKA, supra,*

as an authority to permit the maintenance of appellee's libel in personam against appellant herein is clearly in error. *Reed* v. *SS YAKA, supra,* arose from a bare boat charter executed by Waterman Steamship Co., owner of the SS YAKA, to Pan-Atlantic Steamship Co., Reed's employer. The charterparty contained a full indemnity and hold harmless agreement running to Waterman. While Pan-Atlantic was in full control and possession of the vessel as owner *"pro hoc vice"* under its bare boat charter, Reed, Pan-Atlantic's longshoreman employee was injured. Reed filed a Libel in Rem for unseaworthiness against the SS YAKA. Waterman appeared as owner and claimant and impleaded Pan-Atlantic for indemnity. With the case in this posture Pan-Atlantic, as a defense to the indemnity action, sought to interpose section 905 of the Act. The District Court (E.D. Pa. 1960), 183 F. Supp. 69, held that this defense was not available to Pan-Atlantic. The District Court held that Reed could recover in rem against the SS YAKA for unseaworthiness and that Waterman, under the indemnity clause of the bare boat charter, was entitled to full indemnity from Pan-Atlantic. United States District Judge Clary in the course of the decision admitted the result would be different if one person (as here) is both owner and employer, saying:

> "There are reasons why a court might find otherwise when only one person is involved as owner-stevedore combined." (page 77)

On appeal to the 3rd Circuit, *Reed* v. *SS YAKA,* 307 F.2d 203 (3d Cir. 1961), the court held, under *Smith* v.

The MORMACDALE, 198 F.2d 849 (1952) cert. den., 345 U.S. 908 (1953), that Waterman was not liable for the unseaworthiness of the SS YAKA because the unseaworthy condition arose after the bare boat charter was affected. On petition for rehearing, Chief Justice Biggs dissented and was joined by Circuit Judge Staley, who said at page 207:

> "I join Chief Judge Biggs in his conclusion in his dissent. I read his dissent as not disturbing *Smith* v. *MORMACDALE,* 198 F.2d 849 (C.A. 3, 1952) where the employer was also the shipowner."

The Supreme Court reversed the Third Circuit, thus returning the case to its former posture as a result of the holding at the trial level. The YAKA was liable in rem to Reed for unseaworthiness, and Waterman was to be indemnified by Pan-Atlantic. It is to be remembered that Pan-Atlantic was not the defendant in the case but was a third party defendant and was so treated by the Supreme Court. As such, the Longshoreman's and Harbor Workers' Compensation Act did not absolve Pan-Atlantic from its duty of providing a seaworthy vessel merely because of the happenstance that it employed longshoremen. This developed from the court's discussion of the *Ryan* decision and the expansion of the law that the stevedore company may be liable for indemnity to the shipowner in spite of the exclusionary provision of the Longshoremen's and Harbor Workers' Act.

In *Italia Soc.* v. *Oregon Stevedoring Co.,* 376 U.S. 315 (1963) the Supreme Court made clear that its decision in *Reed* v. *SS YAKA, supra,* did not change the rule that the Longshoremen's Act imposes exclusive liability

on the shipowner-employer as distinguished from a contractual undertaking which the employer may make to third parties. Mr. Justice White speaking for the majority of the Court stated at page 320:

> "At last Term in *Reed* v. *Yaka,* 373 U. S. 410, we assumed, without deciding, that a shipowner could recover over from a stevedore for breach of warranty even though the injury-causing defect was latent and the stevedore without fault. We think that the stevedore's implied warranty of workmanlike performance applied in these cases is sufficiently broad to include the respondent's failure to furnish safe equipment pursuant to its contract with the shipowner, notwithstanding that the stevedore would not be liable in tort for its conduct."

The following explanation appears in the margin:

> "If the stevedore is liable in warranty for supplying defective, injury producing equipment, of course the provisions of the Longshoremen's and Harbor Workers' Compensation Act, 44 Stat. 1424, as amended, 33 U.S. Code, secs. 901-950, are no bar to recovery. This question was fully resolved in *Ryan* vs. *Pan-Atlantic Corp.,* 350 U.S. 124, 1956 A.M.C. 9. 'The Act nowhere expressly excludes or limits a shipowner's right, as a third person, to insure itself against such a liability either by a bond of indemnity, or the contractor's own agreement to save the shipowner harmless.' See also *Reed* vs. *SS YAKA.*"

The case at bar is completely distinguishable from the case of *Reed* v *SS YAKA, supra.* This case is not in rem, but is a direct suit by an injured ship repairman against his employer.

The appellant herein is not in the status of a third party contesting a claim for indemnity over against it by a vessel owner for the latter's having been found liable to an injured longshoreman, as in the *Reed* case. The appellant here is not using the exclusionary provisions of the Longshoremen's Act to contest such a claim being made against it in a circuitous fashion. The appellant here is contesting a claim being made directly against it by an injured repairman and therefore seeks the protection of the exclusive liability provisions of the Act to which it is entitled.

The Rationale Which Would Permit a Longshoreman to Sue His Employer Is Not Applicable to Appellee

If the case of *Reed* v. *SS YAKA, supra,* can be construed to permit a longshoreman to rely upon his employer-ship-owner's dual personality to sustain a cause of action against his employer, appellant submits that the rationale employed by the Supreme Court in permitting a longshoreman to do so is not applicable to a repairman in his employer's steady employ.

Longshoremen receive their job opportunities through the offices of a central hiring hall rather than from face to face meetings with their prospective employers. Employers, daily, make known their labor needs to a dispatcher at the hiring hall. The longshoremen are dispatched to their jobs without regard to whom their employer will be or on what vessel they shall work. Longshoremen are not at liberty to pick and choose their employers. Under such hiring practices it is conceivable and is often the practice for any individual longshore-

man to work for three or four different employers during any given week and upon a like number of different vessels of different design, nationality and origin. At times the longshoreman's employer will be an independent stevedore contractor, while at other times his employer will be a shipowner. In the former situation, an injured longshoreman, if he determines his injury was caused by the fault of a third person, could institute a cause of action against the vessel *in rem* or against the shipowner *in personam,* whereas in the latter situation he could not.

The majority of the Supreme Court in *Reed* v. *SS YAKA, supra,* felt that a longshoreman working for a shipowner was in need of the same protection as one employed by an independent contractor and stated at page 415:

> "We have previously said that the Longshoremen's Act must be liberally construed in conformance with its purpose, and in a way which avoids harsh and incongruous results. We think it would produce a harsh and incongruous result, one out of keeping with the dominant intent of Congress to help longshoremen, to distinguish between liability to longshoremen injured under precisely the same circumstances because some draw their pay directly from a shipowner and others from a stevedoring company doing ship's service."

There are other cogent reasons why a longshoreman might be conceded more latitude in a suit against his shipowner-employer and these reasons are nowhere more succinctly expressed than in the language of the Hon-

orable William C. Mathes in *Hugev* v. *Dampsk International,* D.C. S.D. Cal., (1959), 170 F. Supp. 601 at pages 609 and 610:

> "In almost every instance, when a stevedoring contractor commences the work of loading or unloading a seagoing vessel, the ship has arrived in port only a few hours before. She may have been at sea for weeks or months. Almost always, she has ridden some heavy seas. Often she may have rolled and pitched through mountainous seas for days, taken thousands of tons of water over her decks, sailed through freezing and tropical weather, and been beaten by 100 mile an hour gales. Almost surely she will have been serviced by stevedores of varying degrees of competency in other parts (sic) throughout the world . . . It is reasonable to expect, then that many things may be wrong with a freighter and her equipment and appliances when she arrives in port; and she may well be a place of danger even as she docks. And all of these lurking dangers may be due entirely to the hazards of the ship's service."

The appellee herein is not a longshoreman. He is not called upon indiscriminately to work for various employers and upon various ships of varying nationality and design encountering the dangers which lurk thereon. The appellee had been in the appellant's employ for over one year prior to his injury (Tr. 7). He had worked only upon vessels solely owned by his employer (Tr. 86). The tug "BANNOCK" plies only the waters of the Columbia and Willamette rivers not subject to diverse weather conditions and tampering by foreign workmen.

For these reasons, appellee herein, should not be accorded the same latitude in suing his shipowner-employer as might be presumed to be accorded a longshoreman in *Reed* v. *SS YAKA, supra.*

The Tug "BANNOCK" Did Not Warrant Her Seaworthiness

The tug "BANNOCK" tied up next to a derrick crane at appellant's ship repair yard on December 17, 1963. She was surrendered to appellant's shore-based supervisory personnel to affect the intended repairs (Tr. 129). Major overhaul of both her main engines began at once which required the removal of all constituent parts, with the exception of her crankshaft and camshaft (Tr. 124); and which was raised from the vessel by use of the derrick crane and transported by fork lift to the machine shop for testing, refurbishing and replacement if needed. Mr. Robert Piatt testified that the valves were ground, sleeves were removed and replaced, and connecting rods were realigned and the heads were refinished. He further testified that it was necessary to take these parts into the machine shop because the vessel was not equipped to refinish them. He testified the heads had to be taken into town to be milled (Tr. 131, 132). The engine heads were so heavy that they had to be raised from the vessel by a crane (Tr. 131), and were thereafter transported to the machine shop by fork lift.

Thereafter on December 19, 1963, but after appellee was injured, the vessel was placed on appellant's drydock where all shafts were checked for alignment, and the starboard tail shaft was removed and replaced re-

quiring the removal of both rudders. While on drydock, both propellers were removed and replaced. The skin coolers needed to keep the engines cool were tested for leaks by surging soapsuds through the cooling system. Mr. Piatt testified that all of these repairs required the vessel to be drydocked. There were other items of repair not here mentioned.

Mr. Piatt testified and was corroborated by appellee that he was in charge of all the repair work.

The Captain, mate, engineers and cook were aboard the vessel at all times. The Captain had no part in supervising the repair work and he testified that Mr. Piatt was in charge of the vessel. The Captain and mate acted as watchmen to make sure no fires were started during the course of repairs (Tr. 112).

Appellee testified that he had connected the vessel to shoreside power the day prior to his injury and that he was preparing to disconnect the power when he was injured. Therefore, appellant assumes the tug "BANNOCK" was without electrical power.

Appellant recognizes that under the implied warranty of seaworthiness a shipowner is under a duty to maintain the vessel and its appurtenances in a reasonably safe condition suitable for the purposes intended and that this duty is not only owed to members of the crew but to all engaged aboard the ship in work historically performed by a seaman. *Seas Shipping Co.* v. *Sieracki,* 328 U.S. 85 (1946), 1946 A.M.C. 698; *Pope & Talbot* v. *Hawn,* 346 U.S. 406 (1953), 1954 A.M.C. 1. However, it has been authoriatitively settled that the implied war-

ranty of seaworthiness may not be invoked as a basis of liability where the vessel is a dead ship and has been withdrawn from navigation. *West* v. *U.S.,* 361 U.S. 118 (1959); *Latus* v. *U.S.,* 277 F.2d 264 (2 cir. 1960), cert. den. 364 U.S. 827; *McDonald* v *U.S.,* 321 F.2d 437 (3 Cir. 1963); *Bielowski* v. *American Export Lines,* D.C. E.D. Va. 1963, 220 F. Supp. 265; *McQuaid* v. *U.S.,* (3rd Cir. 164), 337 F.2d 483; *M/V HOPERANGE* (5 Cir. 1965), 345 F.2d 451.

In *West* v. *U.S., supra,* the vessel "MARY AUSTIN" was taken from the mothball fleet to Atlantic Port Contractors, Inc. for the purpose of reactivating the vessel. During the course of the work West was injured. The Supreme Court held that the vessel did not warrant her seaworthiness. The Court reasoned that the cases depended upon by West (*Sieracki* v. *Seas Shipping Co., supra,* and *Pope & Talbot* v. *Haun, supra,*) were, instead of undergoing general repairs, in active maritime service in the course of loading and discharging pursuant to a voyage. At page 122 the Court stated:

> "The MARY AUSTIN, as anyone could see, was not in maritime service. . . . This undertaking was not 'ship's work' but a complete overhaul of such nature, magnitude and importance as to require the vessel to be turned over to a ship repair contractor and docked at its pier for the sole purpose of making her seaworthy. It would be an unfair contradiction to say that the owner held the vessel out as seaworthy in such a case."

It is of no significance that the MARY AUSTIN was out of the moth-ball fleet whereas the tug BAN-

NOCK was not. The main point is that both had been temporarily withdrawn from navigation. As stated by Judge Solomon in *Dawson* v. *U.S.,* (D.C. of Oregon 1962) 1962 A.M.C. 2203 at page 2204:

> ". . .; and even though under Navy Regulations, the ship was considered to be in active service.
>
> "In my view, this case is controlled by West vs. United States, 361 U.S. 118, 1960 A.M.C. 15 (1959). The vessel involved in that case had been in the moth-ball fleet and was being reactivated at the time the libellant was injured. However, in my view, that is not a significant distinction."

In *United N.Y. & N.J. Pilots* v. *Halecki, Admx.,* 358 U.S. 613 (1959), the vessel there involved was in a shipyard for its annual overhaul. One job involved was the dismanteling and overhauling the ship's generators, requiring them to be sprayed with carbon tetrachloride which caused Halecki's death. In holding that Halecki's representatives were not entitled to rely upon the vessel's unseaworthiness the Court at page 617 stated:

> "The work that he (Halecki) did was in no way 'the type of work' traditionally done by the ship's crew. It was work that could not even be performed upon a ship ready for sea, but only when the ship was 'dead' with its generators dismantled."

A ship with her engines dismantled and without power from her generators is no less a "dead" ship than one with her generators dismantled.

This Court in *Berryhill* v. *Pacific Far East Line,* (9 Cir. 1956) 238 F.2d 385, affirmed the lower court which held that the ship there involved did not warrant her

seaworthiness. Although that vessel was in dry dock when Berryhill was injured, the philosophy therein expressed anticipated the holding of the Supreme Court in *West* v. *U.S., supra,* at page 387:

> "The facts in this instant case would extend the doctrine of absolute liability for unseaworthiness (*Mahnick* vs. *Southern Steamship Company,* 321 U.S. 96, 100, 1944 A.M.C. 1) beyond any previous holdings. Here the repairs had nothing to do with the loading or unloading the ship. The propulsion machinery of the vessel itself was being repaired. Not all repairs are "ship's work," to be performed historically or currently, by the crew."

The Honorable Judge Carter in *Gill* v. *TANCRED,* (D.C. N.D. Cal., 1957), 1958 A.M.C. 670, followed the rationale of *Berryhill, supra,* in holding that the vessel SS TANCRED did not warrant her seaworthiness. Judge Carter pointed out that the vessel's "main propulsion machinery" was damaged in an explosion and had to be towed into port. Judge Carter stated at page 672:

> . . . "the vessel was temporarily completely withdrawn from the mainstream of maritime commerce."

The same philosophy was expressed by the Third Circuit recently in affirming the lower court which held that a vessel tied to a pier for the purpose of undergoing repair prior to deactivation does not warrant her seaworthiness.

> "The warranty of seaworthiness does not extend to a shore based employee who, at the time of his injury, was engaged with others in the general over-

> haul and renovation of a vessel temporarily withdrawn from maritime service. Such work is customarily performed in a shipyard equipped for that purpose, and is not traditionally performed by a seaman."

McDonald v. *U. S.* (3d Cir. 1953), 321 F.2d 437 at page 440.

In conclusion we point out that the tug BANNOCK was undergoing major repairs under the supervision and control of the ship repair personnel, requiring such specialized equipment as a valve grinding machine, head milling machine, a derrick crane and fork lifts, none of which are normally carried aboard a tug.

The case law controlling this case, including the latest word from the Supreme Court, is that a vessel which has been withdrawn temporarily from maritime service while undergoing "general" repairs, does not warrant its seaworthiness.

It makes no difference if the vessel has been removed from maritime service because her lines have been filled with preservatives as in *West* or because her propulsion machinery is damaged by an explosion as in *Gill* v. *SS TANCRED* or because her propulsion machinery is intentionally dismantled as in *Halecki* and *Berryhill.*

This Court in deciding *Berryhill* v. *Pacific Far East Lines, supra,* in discussing the view of the Supreme

Court in *Pope & Talbot* v. *Hawn, supra,* stated at page 387:

> "The Supreme Court refers to repairs Hawn was making to the loading equipment as 'slight.' The purpose of his repairing was to permit loading 'to go on at once.' This would indicate a doubt in the Court's mind if any very general repairs to a ship could, or should, be included as 'ship's work.' "

Appellee Was Not Doing The Work Historically Performed by a Seaman

It is axiomatic that a shore based worker is not entitled to the Warranty of Seawoorthiness unless he is engaged, at the time he is injured; in work traditionally performed by a seaman.

> *Seas Shipping Co.* v. *Seiracki,* 328 U.S. 85 (1946); *Pope & Talbot* v. *Hawn,* 346 U.S. 406 (1954).

The appellee was injured aboard appellant's vessel on December 19, 1963. He initially boarded the vessel on December 18, 1963, for the purpose of equipping her with shore side electrical power (Tr. 13). The following day, appellee returned aboard the vessel, this time for the purpose of making arrangements to install a "whistle" light, a job which he neither started or finished (Tr. 126). At the moment of his injury, appellee testified that he was going ashore to disconnect the shore side power prior to dry docking the vessel (Tr. 89-90). Appellee is a man with several years experience as a seaman on ocean going vessels and he himself testified that in all of his experience as an electrician he had

never connected a vessel to or disconnected a vessel from shoreside power.

The District Court erred in holding that appellee was entitled to the warranty of seaworthiness.

CONCLUSION

The Longshoremen's and Harbor Workers' Compensation Act makes the payment of compensation the exclusive liability of an employer to his injured employee. The Courts are not free to rewrite the provisions of the Act and make what was intended as a complete immunity from direct suits for damages, no immunity at all.

The inescapable fact is that *Reed* v. *SS YAKA, supra,* was a suit brought by Reed against the property of a third person, and it is beyond question that it was so treated by the Supreme Court. There was nothing said by the Court in that case which would permit the appellee herein to bring a direct suit against his employer.

There might be reasons why a longshoreman would be allowed to bring a direct suit against his employer, but none of those reasons would permit a like suit by a ship repairman who is steadily employed by one employer and who works only upon vessels owned solely by his employer.

The latest word from the Supreme Court is that a vessel undergoing general repairs does not warrant its seaworthiness. It is incumbent upon this Court to hold

in accord with the law expressed by the Supreme Court in *West* v. *U. S., supra.*

Regardless of a vessel's status, before a shore-based worker can bring himself within the ambit of the warranty of seaworthiness, he must show that he was, at the time of his injury, engaged in work historically performed by a seaman. The appellee has shown only that he was injured aboard a vessel while engaged in a shoreside activity.

Respectfully submitted,

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CERTIFICATE

We certify that, in connection with the preparation of this brief, we have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit and that, in our opinion, the foregong brief is in full compliance with these rules.

EUGENE D. COX
Of Proctors for Appellant

No. 21080

United States
COURT OF APPEALS
for the Ninth Circuit

PACIFIC INLAND NAVIGATION COMPANY, a corporation,

Appellant-Cross-Appellee,

v.

DELBERT A. COURSE,

Appellee-Cross-Appellant.

Appeal from the United States District Court for the District of Oregon

HONORABLE JOHN F. KILKENNY

BRIEF OF APPELLEE

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BRIEF OF APPELLEE

JURISDICTION

The appellee concurs with the statement of jurisdiction as set forth in the Brief of Appellant.

STATEMENT OF THE CASE

This action involves a Libel in Personam for damages based on unseaworthiness of the tug "BANNOCK" instituted by a ship repairman-marine electrician, Del-

bert A. Course, appellee, against his employer-shipowner, Pacific Inland Navigation Company, appellant. It arose from a shipboard accident on December 19, 1963, at Vancouver, Washington, when appellee fell through a hatchway which was inadequately covered with a piece of plywood over which appellant's employees had thrown the canvas cover of a lifeboat. The appellee had been on the bridge of the tug BANNOCK with the Captain of the vessel for the purpose of installing an amber whistle light (a light on top of the wheelhouse which flashes when the ship's whistle sounds and is used by other vessels to locate the vessel sounding the whistle). The appellee was leaving the bridge and going ashore, when the accident happened. At the time of the accident, the tug was afloat and had auxiliary power and electrical power. Most of the crew was aboard. The captain had just approved the location picked out by the appellee for the installation of the whistle light.

The vessel was undergoing a minor annual overhaul. Prior to the accident, some repairs had been commenced on the engines by the ship's engineers, and subsequent to the accident the vessel was moved to dry dock, whether or not under her own power is not known.

The trial court held that the vessel was unseaworthy, that it was in navigation and not a dead ship; that the appellee was performing a service traditionally performed by seamen, and that the appellee was entitled to bring his action against his employer, the appellant, under the doctrine of *Reed* v. *S. S. Yaka,* 373 U.S. 410, 83 S. Ct. 1349, 10 L. Ed. 2d 448.

The unseaworthiness of the tug BANNOCK and the damages awarded appellee are not issues in this appeal.

SUMMARY OF ARGUMENT

1. A ship's repairman engaged in work traditionally performed by seamen is entitled to the warranty of seaworthiness.

2. The warranty of seaworthiness extends to a ship's repairman, both where the vessel is owned or under the control of a third person and where (as here) it is owned and operated by the repairman's direct employer.

3. The mere fact that the ship's repairman is receiving benefits under the Longshoremen and Harbor Workers' Compensation Act does not bar his action for unseaworthiness against his direct employer.

4. The tug BANNOCK, at the time of the appellee's injury, was afloat, moored to a dock, undergoing a minor annual overhaul, and warranted its seaworthiness. It was not a dead ship out of navigation.

5. Since the appellee was engaged in work traditionally performed by seamen, he is entitled to the warranty of seaworthiness, and the fact that he was regularly employed by the appellant as a marine electrician, rather than as a longshoreman, is of no significance to this appeal.

ARGUMENT

A harbor worker injured on a vessel while employed in work traditionally performed by seamen is entitled to the warranty of seaworthiness from his employer-ship owner, although receiving benefits under The Longshoremen's and Harbor Workers' Compensation Act.

The keystone decision of *THE OSCEOLA* (1903) 189 U.S. 158, 23 S. Ct. 483, 57 L. ed. 760, set forth for the first time the proposition that the fate of an injured seaman was linked with vessel unseaworthiness and gave him an effective remedy against the ship. Of the four propositions set forth in the case, the second one, at page 175, states:

> "2. That the vessel and her owner are, both by English and American law, liable to an indemnity for injuries received by seamen in consequence of the unseaworthiness of the ship, or a failure to supply and keep in order the proper appliances appurtenant to the ship. *Scarff* v. *Metcalf,* 107 N.Y. 211, 13 N.E. 796."

Following this decision, the question was raised as to whether or not the work of a longshoreman was in the nature of a maritime service. The Supreme Court answered in the affirmative in *Atlantic Transport Company of West Virginia* v. *Imbrovek* (1913), 234 U.S. 52, 34 S. Ct. 733, 58 L. ed. 1208, where the Court held, at page 61:

> "The libellant was injured on a ship, lying in navigable waters, and while he was engaged in the performance of a maritime service. We entertain

no doubt that the service in loading and stowing a ship's cargo is of this character. Upon its proper performance depend in large measure the safe carrying of the cargo and the safety of the ship itself; and it is a service absolutely necessary to enable the ship to discharge its maritime duty. Formerly the work was done by the ship's crew; but, owing to the exigencies of increasing commerce and the demand for rapidity and special skill, it has become a specialized service devolving upon a class 'as clearly identified with maritime affairs as are the mariners.' "

With the enactment of the Longshoremen's and Harbor Workers' Compensation Act in March, 1927, 44 Stat. 1424, 33 U.S.C. 901, et seq., the further question was raised in the case of *Seas Shipping Co.* v. *Sieracki* (1946) 328 U.S. 85, 66 S. Ct. 872, 90 L. ed. 1099, as to whether the longshoremen would have the seamen's remedy under the General Maritime Law for injuries proximately caused by the unseaworthiness of the ship. The crux of the controversy was whether the ship owners' obligation for unseaworthiness to seamen extended to longshoremen injured while doing the ship's work, but while employed by an independent stevedoring contractor whom the employer had hired to load or unload the vessel. The Court held, at page 97, as follows:

"Accordingly we think the Court of Appeals correctly held that the liability arises as an incident, not merely of the seaman's contract, but of performing the ship's services with the owner's consent. For this view, in addition to the states con-

sideration of principle, the court rightly found support in the trend and policy of this Court's decisions, especially in International Stevedoring Co. v. Haverty, 272 US 50, 71 L ed 157, 47 S Ct 19; Atlantic Transport Co. v. Imbrovek, 234 US 52, 58 L ed 1208, 34 S Ct 733, 51 LRA (NS) 1157, and Uravic v. F. Jarka Co. 282 US 234, 35 L ed 312, 51 S Ct 111."

and, further, at page 99:

"Running through all of these cases, therefore, to sustain the stevedore's recovery is a common core of policy which has been controlling, although the specific issue has varied from a question of admiralty jurisdiction to one of coverage under statutory liability within the admiralty field. It is that for injuries incurred while working on board the ship in navigable waters the stevedore is entitled to the seaman's traditional and statutory protections, regardless of the fact that he is employed immediately by another than the owner. *For these purposes he is, in short, a seaman because he is doing a seaman's work and incurring a seaman's hazards.* Moreover, to make the policy effective, his employer is brought within the liability which is peculiar to the employment relation to the extent that and because he also undertakes the services of the ship." (Emphasis added)

Following the *Sieracki* decision (supra), many lower courts attempted to limit the doctrine solely to longshoremen and not to include other ship's repairmen. See *Guerrini* v. *United States,* 167 F.2d 352 (C.C.A. 2d 1948) and *Christiansen* v. *United States,* 94 F. Supp. 934, 192 F.2d 199 (C.A., First Cir. 1951).

The issue came before the Supreme Court in *Pope & Talbot, Inc.* v. *Hawn* (1954), 346 U.S. 406, 74 S. Ct. 202, 98 L. ed. 143. Hawn was a carpenter doing carpentery work on grain loading equipment at the time of his injuries. He brought a civil action in the United States District Court, charging that his injuries resulted from the vessel's unseaworthiness and Pope & Talbot's negligence. The issue was raised that Hawn was a carpenter, while Sieracki was a stevedore. The Supreme Court held, at page 412, as follows:

> ". . . We are asked, however, to distinguish this case from our holding there. It is pointed out that Sieracki was a 'stevedore.' Hawn was not. And Hawn was not loading the vessel. On these grounds we are asked to deny Hawn the protection we held the law gave Sieracki. These slight differences in fact cannot fairly justify the distinction urged as between the two cases. Sieracki's legal protection was not based on the name 'stevedore' but on the type of work he did and its relationship to the ship and to the historic doctrine of seaworthiness. The ship on which Hawn was hurt was being loaded with the grain loading equipment developed a slight defect. Hawn was put to work on it so that the loading could go on at once. There he was hurt. His need for protection from unseaworthiness was neither more nor less than that of the stevedores then working with him on the ship or of seamen who had been or were about to go on a voyage. *All were subjected to the same danger. All were entitled to like treatment under the law.*" (Emphasis added)

The Court further found, at page 413 of the report:

> ". . . The fact that Sieracki upheld the right of workers like Hawn to recover for unseaworthiness does not justify an argument that the Court thereby blotted out their long-recognized right to recover in admiralty for negligence."

The Court further stated, at page 411:

> ". . . Of course the substantial rights of an injured person are not to be determined differently whether his case is labelled 'law side' or 'admiralty side' on a district court's docket."

The Supreme Court then reaffirmed its position that those who do the type of work traditionally done by seamen, no matter how labeled, are entitled to a seaworthy ship.

In *United New York and New Jersey Sandy Hook Pilots Association* v. *Halecki,* 358 U.S. 613, 79 S. Ct. 517, 523, 3 L. ed. 2d 541, the Court stated, at page 617:

> ". . . Seas Shipping Co. v. Sieracki and Pope & Talbot, Inc. v. Hawn made clear that the shipowner could not escape liability for unseaworthiness by delegating to others work traditionally done by members of the crew. Whether their calling be labeled 'stevedore,' 'carpenter,' or something else, those who did the 'type of work' traditionally done by seamen, and were thus related to the ship in the same way as seamen 'who had been or who were about to go on a voyage,' were entitled to a seaworthy ship. See 346 US at 413."

And in *The Vessel M/V "TUNGUS"* v. *Skovgaard,* 358 U.S. 588, 79 S. Ct. 503, 523, 3 L. ed. 2d 524, the Supreme Court applied the same doctrine to a main-

tenance foreman unloading oil from a vessel. It is stated, at 3 L. ed. 2d, page 530:

> "The Court of Appeals also determined that the decedent was within the class protected by the warranty of seaworthiness as developed by federal maritime law, which it found the New Jersey statute had incorporated. This subsidiary determination is clearly correct. The decedent's status is practically indistinguishable from that of the plaintiff in Pope & Talbot, Inc. v. Hawn, 346 US 406, 98 L ed 143, 74 S Ct 202, the only difference being that the cargo here was oil instead of grain, and was being unloaded instead of loaded."

To like effect, are *Feinman* v. *A. H. Bull S.S. Company* (1952) (D.C. Pa.), 107 F. Supp. 153 (an electrician);

Bow v. *Pilato* (1949) (D.C., So. Dist. California), 82 F. Supp, 399 (an engineer);

Imperial Oil, Ltd v. *Drilik,* 234 F.2d 4 (6th Cir. 1956), a line handler);

Ross v. *SS ZEELAND,* 240 F.2d 820 (4th Cir. 1957) (a night watchman);

Shenker v. *U. S.,* 322 F.2d 622 (2d Cir. 1963) (a time keeper);

Sacony-Vacuum Oil Co., Inc. v. *Lawlor,* 275 F.2d 599 (2d Cir. 1960) (a shipyard worker on overhauled tanker);

Pioneer SS Co. v. *Hill,* 227 F.2d 262 (6th Cir. 1956) (a shipfitter's helper).

See annotation, "Who, other than seamen, are entitled to benefits of seaworthiness doctrine — federal cases," 3 L. ed. 2d 1764.

Concurrently with this broad concept of extending the protection of seaworthiness to all shoreside workers, injured while doing work traditionally performed by seamen, there developed the concept of indemnity by the employer to the shipowner if the cause of the accident was due to the action or inaction of said employer. *Ryan Stevedoring Co.* v. *Pan-Atlantic Steamship Corp.*, 350 U.S. 124, 100 L. ed. 133, involved an injury due to unsafe storage of cargo, wherein the original plaintiff obtained judgment against the ship owner, even though he had received benefits under the Longshoremen's Act. It was held that the stevedoring company would be responsible to indemnify the ship owner for such loss, even though the result would be that the employer would then be buying compensation insurance and, in addition thereto, would be paying additional sums to ship owners by reason of negligence of the employer or his employees.

Following the *Hawn* decision and its progeny (supra), the next issue was obvious. Could a ship owner insulate himself from liability to *Sieracki* and *Hawn* stevedores and repairmen if he performed his own stevedoring and repair work, or, to state otherwise, could a harbor worker employee bring an action against a ship owner direct employer, where the employer wore two hats—one as a stevedoring company and other as a shipowner—while such an employee was covered under the

Longshoremen's and Harbor Workers Compensation Act?

The answer was not long in forthcoming in *Reed* v. *SS YAKA,* 373 U.S. 410, 83 S. Ct. 1349, 10 L. ed. 2d 448. The Court, putting together the two developing concepts set forth in *Hawn* and *Ryan,* met the issue squarely by saying, at page 414:

> ". . . we pointed out several times in the *Sieracki* case, which has been consistently followed since, that a ship owner's obligation of seaworthiness cannot be shifted about, limited, or escaped by contracts or by the absence of contracts, and that the ship owner's obligation is rooted, not in contracts, but in the hazards of the work . . . In making this argument Pan-Atlantic has not pointed and could not point to any economic difference between giving relief in this case, where the owner acted as his own stevedore, and in one in which the owner hires an independent company. In either case, under Ryan, the burden ultimately falls on the company whose default caused the injury."

As to the exclusiveness of the Longshoremen's and Harbor Workers' Act, the Court continued, at page 414:

> ". . . Pan-Atlantic relies simply on the literal wording of the statute, and it must be admitted that the statute on its face lends support to Pan-Atlantic's construction. But we cannot now consider the wording of the statute alone. We must view it in light of our prior cases in this area, like Sieracki, Ryan, and others, the holdings of which have been left unchanged by Congress. . . . In light of this whole body of law, statutory and decisional, only

blind adherence to the superficial meaning of a statute could prompt us to ignore the fact that Pan-Atlantic was not only an employer of longshoremen but was also a bareboat charterer and operator of a ship and, as such, was charged with the traditional absolute, and nondelegable obligation of seaworthiness which it should not be permitted to avoid. We have previously said that the Longshoremen's Act, 'must be liberally construed in conformance with its purpose, and in a way which avoids harsh and incongruous results.' "

The Court further considered the fact that Pan-Atlantic was a bareboat charterer from Waterman. It held, at 373 U.S. 412:

> ". . . It has long been recognized in the law of admiralty that for many, if not most, purposes the bareboat charterer is to be treated as the owner, generally called owner pro hac vice."

To argue, as appellant does, that a ship-owner-employer may not be sued for damages by an employee because of the exclusive provisions of the Act is to completely ignore the literal wording of the case, which, as the Court stated at page 415 of the report:

> "We think it would produce a harsh and incongruous result, one out of keeping with the dominant intent of Congress to help longshoremen, to distinguish between liability to longshoremen injured under precisely the same circumstances because some draw their pay directly from a shipowner and others from a stevedoring company doing the ship's service. Petitioner's need for protection from unseaworthiness was neither more nor less than that

> of a longshoreman working for a stevedoring company. . . ."

Appellee submits that the case plainly sets forth the proposition that a ship owner cannot insulate itself from liability to an injured harbor worker by acting as its own stevedoring and repair company.

In the May, 1964, issue of the Stanford Law Review, the Notewriter discusses *Reed* v. *YAKA* as follows, at pages 563-64:

> "There is no question about squaring this decision with the Longshoremen's Act. As the dissent pointed out, it simply cannot be done. In effect, section 5 of the Act, which makes the employer's liability for compensation 'exclusive and in place of all other liability . . . at law or in admiralty on account of such injury,' must be regarded as amended by a proviso: 'provided the employer is not an owner or operator of a ship.'
>
> "The decision does not rest on an inscrutable mystery of the maritime libel in rem. This is fairly clear from the opinion itself. And in one recent lower court decision, Yake was construed, quite rightly it would seem, to allow a longshoreman to sue his bareboat-charterer-employer for unseaworthiness in a personal action on the law side of the federal district court."[1]

This proposition is sustained by *Hertel* v. *American Export Lines, Inc.,* 225 F. Supp. 703 (1964) (U. S. Dist. Ct., 7th Dist. N. Y.), wherein the plaintiff, a longshoreman injured aboard a vessel owned by his employer

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[1] *Hertel* v. *American Export Lines,* 225 F. Supp. 703 (S.D. N.Y. 1964).

brought an action for breach of warranty for seaworthiness and negligence under the Jones Act. In regard to the issue of the breach of warranty, the Court held, at page 704,

> "The right to maintain the unseaworthiness claim finds full support in Reed v. The Yaka. . . ."
>
> . . . . .
>
> "The underlying rationale of the reversal was grounded upon the broad humanitarian policy of the doctrine of unseaworthiness and its purpose to protect all those engaged in the ship's service against the hazards of unseaworthiness. It rested upon the absolute and nondelegable duty of a shipowner, whether the actual owner or owner *pro hac vice,* to live up to the warranty of seaworthiness, and in the event of a breach, to afford the traditional remedies to an injured person to whom the duty is owing, whether he is a crew member or performing a crew member's work. . . . To have denied him relief upon the unseaworthiness claim would have negated the conceptual doctrine of Seas Shipping Co. v. Sieracki, and its progeny, whereby a longshoreman engaged in the performance of the traditional work of a crew member is afforded the same rights upon such a claim as a regular crew member."

The appellant does not cite the case of *Biggs* v. *Norfolk Dredging Co.,* 360 F.2d 360 (1966) (C.C.A., 4th Cir.), although appellant relied upon the lower court's decision in this case to a great extent at the time of trial in the instant case.

Biggs v. *Norfolk Dredging Co.,* 237 F. Supp. 590 and

Clower v. *Tidewater Raymond Kiewit,* 237 F. Supp. 1015, both from the United States District Court, Eastern District of Virginia, Norfolk Division, attempted to limit the scope of the *Reed* decision. Judge Hoffman stated, in the *Biggs* case, at 237 F. Supp., page 598:

> "Plaintiff, in the instant proceeding, would have us extend the Reed doctrine to include any maritime worker *allegedly* doing the traditional work of seamen, thereby requiring courts to go behind final awards under state or federal compensation acts, and calling upon district courts and juries to re-examine any and all factual contentions. We do not believe that Reed was ever intended to bring about this result. In Reed, the libelant was undeniably in the status of a longshoreman. The same is true in Hertel v. American Export Line, S.D. N.Y., 225 F. Supp. 703. . . . We hold that the limiting effect of Reed must be confined to instances in which the claimant is undeniably a longshoreman working aboard a vessel owned and operated by his stevedore-employer."

Biggs was listed on the payroll as a temporary yard helper. He had a Coast Guard certificate as a seaman and had on occasion handled lines and assisted in maneuvering barges used for the purpose of raising and re-assembling a pipe line submerged in the Elizabeth River in Virginia. On the date of the accident, he was on a derrick barge when a section of the pipe struck him and injured him. Clowers was hired and classified as a carpenter, but principally worked upon a large unit of equipment known as, "The Monster," which placed caps upon the piles of a bridge trestle, which was a sec-

tion of the Chesapeake Bay bridge tunnel. At times, he had been engaged aboard barges and at other times he had acted as a survey rodman on still another ship.

The Fourth Circuit reversed both cases, and (though both turned upon whether a summary judgment was the appropriate remedy against the defendants), the Court met the issue here in point by stating that the *Reed* v. *S.S. Yaka* decision applied to each of the appellants. pra), 360 F2d 360, at page 363:

> "The determinative factors in Reed v. The S.S. Yaka, supra, 373 U.S. 410, 83 S. Ct. 1349, are present in each case here. The Supreme Court's ruling was this: if an employer is the permanent or pro hac vice owner of the ship on which his employee is injured while working as a longshoreman, then the employee may sue his employer under the general maritime law for damages, notwithstanding that previously the employee has received compensation."

After quoting the *Reed* v. *The S. S. Yaka* decision, the Court again, at 360 F.2d 364:

> "Like reasoning applies to the instant cases. Each plaintiff now pleads himself a seaman, or alternatively as one doing a seaman's job, and thereby entitled to sue for unseaworthiness. See Seas Shipping Co. v. Sieracki, 328 U.S. 85, 99 66 S. Ct. 872 (1946). It is now elementary that all who do traditional seaman's work are owed, and may sue on, the warranty of seaworthiness. See, e.g., Pope & Talbot, Inc., v. Hawn, 346 U.S. 406, 74 S. Ct. 202, 98 L. Ed. 143 (1953); Ross v S.S. Zeeland, 240 F.2d 820 (4 Cir. 1957); Lawlor v. Socony-Vacuum Oil

> Co., 275 F.2d 599, 84 A.L.R.2d 613 (2 Cir. 1960), cert. den. 363 U.S. 844, 80 S. Ct. 1614, 4 L. Ed. 2d 1728 The present plaintiffs may also be armed in like fashion"

and at page 365:

> ". . . that *Yaka* peremptorily dictates, to repeat, that a seaman-employee, actual or *Sieracki,* injured aboard his employer's vessel is to be put in the same position as one injured aboard a ship owned by a third party, and in the latter situation, the employee could recover compensation from his employer and still sue the third party for negligence or unseaworthiness."

Reed v. S.S. YAKA is not a decision based on procedural maneuvers. It stands for the substantive rule that a worker injured aboard a vessel owned by his employer may bring an action for seaworthiness although receiving compensation under The Longshoremen's and Harbor Workers Compensation Act.

Appellant further seeks to distinguish away the rationale of *Reed* v. *The Yaka* (*supra*). Appellee submits that these are distinctions of form and not of substance and should be treated as distinctions without a difference.

The first distinction made by the appellant is that Reed was a longshoreman and Course, the appellee, was a maritime electrician. This distinction was raised in many cases subsequent to the *Sieracki* decision and is commented upon supra. The *Hawn, Tungus* and the *Halecki* cases, cited *supra,* make this a distinction with-

out difference. To again quote the Supreme Court, in the *Halecki case* (*supra*), 358 U.S. at page 617.

> ". . . .Seas Shipping Co. v. Sieracki and Pope & Talbot, Inc. v. Hawn made clear that the shipowner could not escape liability for unseaworthiness in delegating to others work traditionally done by members of the crew Whether their calling be labeled 'stevedore,' 'carpenter,' or something else, those who did the 'type of work' traditionally done by seamen, and were thus related to the ship in the same way as seamen 'who had been or were about to go on a voyage,' were entitled to a seaworthy ship. See 346 US at 413."

It is worth while noting that appellant cites no cases to this proposition, although appellee has cited several decisions, *Guerrini* v. *United States,* and *Christiansen* v. *United States* (*supra*), that stand for appellant's proposition but were decided prior to the *Hawn, Tungus* and *Halecki* decisions (*supra*).

The second distinction that appellant seeks to make is that *Reed* was a libel in rem against the vessel and that neither Waterman Steamship Corporation, its owner, nor Pan-Atlantic Steamship Company, its owner *pro hac vice* and libelant's employer, were in personam defendants. Following the libel, Waterman appeared as claimant of the ship and impleaded Pan-Atlantic, the bareboat charterer. The District Court Judge held that the vessel was unseaworthy because of a defective pallet supplied by Pan-Atlantic, and that Reed could recover against the ship, and that Waterman could then recover against Pan-Atlantic because of an indemnity

clause in the bareboat charter. The Court of Appeals for the Third Circuit reversed the judgment, holding that neither Waterman nor Pan-Atlantic could be held personally liable for the unseaworthiness, Waterman because the unseaworthiness condition arose after Pan-Atlantic became owner *pro hac vice* of the vessel, and Pan-Atlantic, because is was insulated by the Longshoremen's and Harbor Workers' Compensation Act.

The Supreme Court reversed the Court of Appeals' decision, "Pan-Atlantic could not have been held personally liable to the petitioner for unseaworthiness because Pan-Atlantic was petitioner's employer under the Longshoremen's & Harbor Workers' Compensation Act," by stating at 373 U.S., page 412,

> "We find it unnecessary to decide whether a ship may ever be held liable for its unseaworthiness where no personal liability could be asserted because, in our view, the *Court of Appeals erred in holding that Pan-Atlantic could not be held personally liable for the unseaworthines of the ship which caused petitioner's injury.*" (emphasis ours)

Let us analyze the appellant's argument further. What would the appellant claim if Pan-Atlantic, the employer, as the bareboat charterer of said vessel, had claimed the vessel and had pleaded the actual owner, Waterman? Would appellant then claim that the *Reed* decision could not apply, since this would be a direct action against the appellee's employer and a third party action against Waterman? Appellant seems to be saying that the procedural steps that are used in getting the

defendant before a court with jurisdiction are more important than the substantive law to be applied to the controversy between the parties once they are before the Court. Appellee submits that the substance of the *Reed* decision is that a *Sieracki* seaman may bring an action against his employer when the employer is acting as his own stevedore and *not* with qualifications set forth by appellant that a libel in rem must be filed and that the vessel must be claimed by the actual owner, who in turn must implead the owner *pro hac vice* as a condition precedent to the liability of a ship owner acting as its own stevedore.

In *Hertel* v. *American Export Lines, Inc.* (*supra*), the defendant attempted to distinguish *The Yaka* case, as the appellant does here and the Court held, at 225 F. Supp. 704:

> "The defendant urges that The Yaka is to be distinguished because it was an in rem action, whereas the instant one is brought on the civil side in personam. However, the hard core of the Court's decision, based as it is upon personal liability of the bareboat charterer, renders the claimed distinction invalid. Neither does the fact that the stevedore has been receiving payments under the Act bar the maintenance of this suit."

The *Clower* case, consolidated with *Biggs* v. *Norfolk Dredging Co.,* 360 F.2d 360 (*supra*) was an action also on the civil side, rather than a libel in rem. The Fourth Circuit had no hesitancy in applying *Reed* v. *The Yaka,* as commented upon supra.

Appellee submits that appellant is relying purely

upon form and completely ignoring the rule in the case when appellant argues that *Reed* v. *The Yaka* only applies in circuitous actions that are in rem.

The Tug BANNOCK was in navigation and therefore warranted her seaworthiness.

The Tug BANNOCK was tied up at the dock (Tr. 14, 85, 139). The crew of seven, or a portion thereof, was aboard, and the crew had not been discharged (Tr. 101-102). The captain of the tug testified that the tug was in for a minor overhaul and that the overhaul was on the basis of the hours that the vessel had actually been running (Tr. 102, 123). He further testified that at the time of the accident electrical power was available from the ship's generator (Tr. 109). One of the ship's crew was working on the engines, and another one was due to work on the engines of the ship from 4:00 P.M. until midnight (Tr. 109). The crew was capable of doing this minor engine overhaul (Tr. 109-112). Sufficient power was available from the ship to run its own welder (Tr. 111). The appellee, Course, asked the captain for his approval in placing the whistle light on the wheel house, and the captain went with Course to the wheel house to see how the whistle light was to be rigged (Tr. 112). One of the engines may have been dismantled (Tr. 136), but the appellant's personnel didn't know whether the vessel used its own power to get to drydock subsequent to the accident or not (Tr. 137). It was in for repairs a total of four to five days (Tr. 139).

In *West* v. *United States,* 361 U.S. 118, 80 S. Ct. 189,

4 L. Ed. 2d 161 (1959), the issue was raised of whether the warranty of seaworthiness applied to harbor worker employee working on a vessel, THE MARY AUSTIN, which had been held in storage in the mothball fleet and was undergoing a complete overhaul, the Supreme Court held, at page 121,

> ". . . It is evident that the sole purpose of the ship's being at Atlantic's repair dock at Philadelphia was to make her seaworthy. The totality of the reparation on the vessel included compliance with the hundred of specifications in the contract calling for the repairing, reconditioning, and replacement, where necessary, of equipment so as to make fit all the machinery, equipment, gear, and every part of the vessel. . . . In short, as the trial court said, the work to be done on the vessel was equivalent to 'home port structural repairs.' "

The Court then laid down this rule:

> ". . . It would appear that the focus should be upon the status of the ship, the pattern of the repairs, and the extensive nature of the work contracted to be done, rather than the specific type of work that each of the numerous shore-based workmen is doing on shipboard at the moment of injury. . . ."

With this, the Court held that a mothball vessel, being reconditioned for sea duty, did not warrant its seaworthiness. This rationale was applied in *Nasta* v. *United States* (1959) (Dist. Ct. N.Y.) 181 F. Supp. 906, affirmed Court of Appeals, 2d Circuit, 288 F.2d 186, where a mothball vessel was undergoing repairs, but was

intended to be returned to the mothball fleet, and in *Huber* v. *United States* (1959) (Dist. Ct. Calif.) 177 F. Supp. 617.

The same rationale was applied in *Berryhill* v. *Pacific Far East Line* (1956) (C.C.A. 9th Circ.) 238 F.2d 385, where a ship was in drydock, and the Court held, at page 387,

> ". . . Not all repairs are 'ship's work', to be performed, historically or currently, by the crew."

The Supreme Court qualified its position in the case of *Roper* v. *United States,* 368 U.S. 20, 82 S. Ct. 5, 7 L. Ed. 2d 1. In this case, the SS. HARRY LANE was a liberty ship that had been mothballed in 1945, and in 1954 had been converted to a grain storage vessel, filled with grain and returned to the dead fleet where it remained for two years. In 1956, a sale of the grain was made and unloading operations were commenced, and the petitioner, the foreman of a longshoremen crew, was injured in the process of this unloading. The Court held, at page 22,

> "The test for determining whether a vessel is in navigation is the 'status of the ship,' West v. United States. . . . This is a *question of fact,* Butler v. Whiteman, 356 US 271, 2 L ed 2d 754, 78 S Ct 734 (1958), and consequently reversible only upon a showing of clear error. (Emphasis added)
>
> . . . . .
>
> "In light of the above circumstances, we cannot say as a matter of law that the S.S. Harry Lane had been converted into a vessel in navigation, and

that the findings of the trial court were clearly erroneous.

> "Since we are unwilling to upset the trial court's factual determination that the S.S. Harry Lane was not a vessel in navigation, it follows that there was no warranty of the ship's seaworthiness."

With this, the Supreme Court left the trial judge's determination of the status of the vessel unchanged.

In *Socony Vacuum Oil Co.* v. *Lawlor,* 275 F.2d 599, 84 A.L.R.2d 613, the Court stated at page 602:

> "Thus the critical question in this case is whether or not the fact that the Mobilfuel was moored in navigable waters at the pier of the shipyard during her annual overhaul gives her a status such that there is no warranty of seaworthiness and no duty to Lawlor to maintain the vessel and her equipment in a seaworthy condition.
>
> ". . . Moreover, we do not think resort to a mere phrase such as 'out of navigation' gets us very far. Surely a vessel that has hit one of the submerged logs or other floating obstructions that plague our large harbors and has damaged her propellers so that she has to be towed to a shipyard for a day or two for repairs before continuing her voyage cannot fairly be said to have so changed her status as to eliminate any duty to the officers and crew on board to maintain the vessel and her equipment in a seaworthy condition until the repairs have been completed. Such a vessel is unable to move under her own power, she is still in navigable waters, and would seem to be no more 'out of navigation' at

the pier of a shipyard than she would be if moored to one of the municipal piers, awaiting tugs to move her to a place where the repair to her propellers could be promptly made. Thus, if being 'out of navigation' is a material factor, everything depends upon what we mean by 'out of navigation' in the context of the doctrine of unseaworthiness. If we were pressed to decide whether the Mobilfuel was 'out of navigation' in navigable waters moored at the Bethlehem pier, we would say she was not 'out of navigation'."

Judge Medina then commented, at page 604:

"We have concluded that the character of the work to be done by the shipyard, the presence or absence of a crew performing the customary work of seamen on shipboard, and the consequent measure of control or lack of control by the shipyard over the vessel as a whole, are the determining factors that rule the decision of this case. Doubtless cases will arise in which the question of fact relative to the degree of control exercised respectively by the shipowner and the shipyard may be difficult of resolution. But here we have no conversion of a prisoner of war transport into a passenger carrier for the families of overseas service men (Lyon v. United States, 2 Cir, 1959, 265 F2d 219), nor extensive repairs amounting virtually to the reconstruction and rebuilding of the vessel (Berge, supra), nor a wholly deactivated vessel from the "moth ball fleet" (West, supra), nothing in the category of major repairs or structural and extensive changes in the vessel, but only a large number of relatively small miscellaneous items such as are generally included in an annual overhaul."

In *Pollock* v. *Standard Oil Company of California*, State of California, District Court of Appeal, First District, Division 2, 42 Cal. R. 128, 1965 A.M.C. 255, the fact situations were similar to those set forth in the *Lawlor* case and in the present case. The Court stated in 1965 A.M.C. at page 258:

> "We shall analogize the factual situation in *Lawlor* with that in the instant action. Our inquiry, of course, is whether the evidence in the instant case is sufficient to require the submission to the jury of the factual question as to whether the barge was 'out of navigation' and thus not subject to the doctrine of unseaworthiness.
>
> "*Character of work done by shipyard.* It is substantially the same in *Lawlor* and respondent Standard Oil makes no contention that it was not. Besides, *West* vs. *United States, supra,* holds that the focus should be placed on the status of the ship, rather than the specific type of work which an injured shore-based workman was doing on the ship at the moment of injury. Moreover, it appears that the patching job being done by plaintiff is one which is customarily done by seamen.
>
> "*General control of the vessel. Lawlor* places significance upon the presence or absence of the crew. The subject barge carried a crew of two men, consisting of a tankerman and a bargeman. When the barge was actually in service, their duties were to handle the hoses and valves during the operation of filling the oil tanks on the barge and to work the pumps in the deckhouse during unloading operation. They were also responsible for general maintenance."

. . . . .

> "In *Lawlor,* as in the instant case, the vessel 'was in dry dock for a few days' for, as stated therein, 'the customary repairs to and painting of the bottom, propellers and so on.' (1960 A.M.C. at 718, 275 F. (2d) at p. 601). Certainly, the regular crew could not have done this type of work but that did not prevent the court in *Lawlor* from applying the doctrine of unseaworthiness."

In *Hilton* v. *Aegean Steamship Co.,* 239 F. Supp. 268 (Dist. Court of Oregon, 1965), the vessel SS DEMOSTHENES was in the repair yard for 12 days and was in drydock for two days. The cost of repairs was $65,000, and the full crew of the vessel remained aboard. The Court held, at page 269:

> "The principal question is whether the SS DEMOSTHENES was a vessel in navigation for the purpose of warranting her seaworthiness. The factors to be considered are 'the character of the work to be done by the shipyard, the presence or absence of a crew performing the customary work of seamen on shipboard, and the consequent measure of control or lack of control.' Lawlor v. Socony-Vacuum Oil Co., 2 Cir. 1960, 275 F.2d 599, 604, 84 A.L.R.2d 613, cert. denied, 363 U.S. 844, 80 S. Ct. 1614, 4 L. Ed. 2d 1728 (1960). The SS DEMOSTHENES was not undergoing a complete overhaul or repairs so extensive in character as to place the vessel out of maritime service; in fact, on the basis of the cost of repairs and the time required to complete them, the repairs were minor. Cf. West v. United States, 361 U.S. 118, 80 S. Ct. 189, 4 L. Ed. 2d 161 (1959); McDonald v. United States, 3 Cir. 1963, 321 F.2d 437, cert. denied, 375 U.S. 969, 84

S. Ct. 487, 11 L. Ed. 2d 417 (1964). In addition, the crew was aboard and in control of the vessel during all such time.

"I therefore find that in the time of the accident the SS DEMOSTHENES was a vessel in navigation for the purpose of warranting her seaworthiness."

On the other end of the spectrum from *West* (*supra*) is *Lusich* v. *Bloomfield Steamship Co.,* 355 F.2d 770 (1966) (U.S.C.A., 5th Cir.) wherein the repairs cost only $311.72, and the Fifth Circuit held that the vessel was not a dead ship.

Based upon the testimony of the appellant's employees and of the appellee and the decisions cited above, it is obvious that the Court's finding that as a matter of fact the Tug BANNOCK was a vessel in navigation and warranted her seaworthiness should not be disturbed.

Appellee was engagged in activities historically performed by a seaman.

When a shore-based worker is engaged in work traditionally performed by a seaman while on a vessel, he is entitled to a seaman's warranty of seaworthiness. *Seas Shipping Co.* v. *Sieracki,* 328 U.S. 85, *Pope & Talbot* v. *Hawn,* 346 U.S. 406.

The appellee had sailed as a second electrician for a year to a year and a half and as a chief electrician after that, during the years of 1949 to 1961 (Tr. 6). He had worked as a maintenance and construction electrician for the appellant from October, 1962, until the date of the

accident (Tr. 8). His first connection with the BANNOCK was arranging for shore power for the ship, with auxiliary generators, and then going aboard to ascertain what material was needed for the installation of the amber whistle light He had gone below and contacted the captain, who went with him to the whistle light and approved where he was to put the whistle light on top of the wheelhouse. The accident occurred after he was leaving the wheelhouse with the captain, after completing his discussion with him about the installation of the amber whistle light (Tr. 13, 111 and 112). The amber whistle light is a light that remains on while the whistle of the ship is being sounded and aids other vessels to locate the ship blowing the whistle (Tr. 13). He was leaving the wheelhouse to go ashore to make further arrangements about shore power (Tr. 89). An electrician aboard ship usually installs lights if they are needed, and the welding and burning in connection therewith is usually done by the engineering department of the ship when they are at sea (Tr. 99). Electricians aboard ship have the duty to see that all electrical circuits, light circuits and power circuits are in working order and have the duty to repair any deficiency in the light circuit or in the lights themselves, and in case one has to be installed or moved, the electrical work is done by the electricians aboard ship (Tr. 125, 126).

It is undisputed that the ambler whistle light being installed by the appellee just prior to his injury was used as a navigational aid by the ship when sounding

her whistle as a signal to other vessels. It is further undisputed that the captain was in the wheelhouse with the appellee for the purpose of approving the location at which the whistle light was to be installed. In other words, his efforts to that time had been directed toward the installation of navigation aiding equipment—a duty historically performed by electricians at sea. Appellant would have the Court disregard this and rely solely upon the fact that he was leaving the vessel to do something about the shore power.

The cases of *Seas Shipping Co.* v. *Sieracki,* 328 U.S. 85, 66 S. Ct. 872, 90 L. ed. 1099, 1946 A.M.C. 698, and *Pope & Talbot, Inc.,* v. *Hawn,* 346 U.S. 406, 74 S. Ct. 202, 98 L. ed. 143, made it clear that the ship owner could not escape liability for unseaworthiness by delegating to others the work traditionally done by members of the crew, whether their calling be labeled "stevedore" of the crew, whether their calling be labeled "stevedore," "carpenter" or something else. All those who did the type of work traditionally done by seamen and were thus related to the ship in the same way as seamen "who had been or who were about to go on a voyage" were entitled to a seaworthy vessel. See 346 U.S. at 413.

Of like effect are *Feinman* v. *A. H. Bull Steamship Co.* (supra) 107 F. Supp. 153 (D.C. Pa. 1952) (an electrician); *Bow* v. *Pilato,* 82 F. Supp. 399 (1949, U.S.D.C., So. Dist. California) (an engineer), and *Imperial Oil, Ltd.* v. *Drilik,* 234 F.2d 4 (6th Cir. 1956) (a line handler).

In *Pope & Talbot, Inc.* v. *Cordray,* 258 F.2d 214

(C.C.A. 9th Cir.), libelant was aboard the vessel at the time of his injury for the purpose of coordinating cargo handling work of the dock longshoremen with that of the longshoremen working on the vessel, although most of this time had been spent upon shore. The Court held at page 217:

> "In the instant case the appellee, although performing most of his work on the dock in the moving of the ship's cargo from ship's tackle to its first place of rest (which was part of the ship's obligation), was on board the ship when the accident happened. Under the testimony, he was coordinating the unloading of the cargo from the ship's hold to its place of rest on the dock. We hold that the duty of providing a seaworthy ship and gear at the time of this accident extended to the appellee, whether or not appellee was on board the ship or on the dock. The test is, what was the nature of his work? He was performing a service for the ship in the discharge of its cargo. His employer was under contract with the shipowner to take the cargo from the shipside and to put it in a place of storage, and appellee was engaged in the performance of this work. The appellee's work was the work of a longshoreman and he was entitled to seaworthy gear while he was performing his services."

The decision of *Roper* v. *United States* (*supra*), 368 U.S. 20, 82 S. Ct. 5, 7 L. Ed. 2d 1, seems to be the ultimate answer, wherein it is held that whether or not the vessel was in navigation was a matter of fact to be determined by the trial court.

Appellee submits that appellee was engaged in activities traditionally performed by seamen, and that the

decision of the trial court on the issue of fact is based upon the substantial evidence offered by both the appellee and the appellant.

CROSS APPEAL

The District Court erred in dismissing the Appellee's negligence action against the Appellant because Appellee, as a workman aboard a vessel, is owed the duty of reasonable care by the vessel's owner.

SUMMARY OF ARGUMENT

1. Persons working on a vessel or transacting business thereon may recover for damages caused them as a result of a ship owner's negligence.

2. Since appellee's employer was both the ship owner-operator and the harbor worker employer, appellee may recover against him in his ship owner-operator capacity in negligence.

ARGUMENT

A harbor worker may proceed against the owner of a vessel for damages arising out of tort, whether or not the vessel owner is his employer.

The Steamer MAX MORRIS v. *Patrick Curry, et al.*, 137 U.S. 1, 11 S. Ct. 29, 34 L. ed. 586 (1890) was the original case that set the premise cited above. In that case, a longshoreman, employed to load coal aboard a steamship and injured in a fall from the steamer's bridge to her deck, was held to have an action for negligence in admiralty against the vessel.

As recently as *Pope & Talbot* v. *Hawn* (*supra*), 346 U.S. 406, 74 S. Ct. 202, 98 L. ed. 143 (1953), the Supreme Court affirmed the rule that workers, such as the appellee herein, may recover for negligence in admiralty, stating at page 413:

> "A concurring opinion here raises a question concerning the right of Hawn to recover for negligence—a question neither presented nor urged by Pope & Talbot. It argues that the Sieracki Case, by sustaining the right of persons like Hawn to sue for unseaworthiness, placed them in the category of 'seamen' who cannot, under The Osceola, 189 US 158, 47 L ed 760, 23 S Ct 483, maintain a negligence action against the shipowner. The Osceola held that a crew member employed by the ship could not recover from his employer for negligence of the master or the crew member's 'fellow servants.' Recoveries of crew members were limited to actions for unseaworthiness and maintenance and cure. But Hawn was not a crew member. He was not employed by the ship. The ship's crew were not his fellow servants. Having no contract of employment with the shipowner, he was not entitled to maintenance and cure. *The fact that Sieracki upheld the right of workers like Hawn to recover for unseaworthiness does not justify an argument that the Court thereby blotted out their long-recognized right to recover in admiralty for negligence.*" (Emphasis added)

. . . . .

> "Illustrative of the unbroken line of federal cases holding that persons working on ships for independent contractors or persons rightfully trans-

> acting business on ships can recover for damages due to shipowners' negligence are: Leathers v. Blessing, 105 US 626, 26 L ed 1192 (1882); The Max Morris, 137 US 1, 34 L ed 586 11 S Ct, 29 (1890); Gerrity v. The Kate Cann, 2 F 241 (1880, DC NY); The Helios, 12 F 732 (1882, DC NY), decision by Judge Addison Brown; Grays Harbor Stevedore Co. v. Fountain, 5 F2d 385 (1925, CA 9th Cal); Brady v. Roosevelt S S Co., 317 US 575, 577, 87 L ed 471, 474, 63 S Ct 425 (1943). See also cases collected in 44 ALR 1025-1034."

The position held by this appellee was commented on by Justice Frankfurter in his concurring opinion at page 417.

> "On the one hand, it may be urged that Sieracki broadened the rights of shore workers; it gave them a seaman's status without depriving them of the right of action they had before they attained that status. . . ."

Although a great deal of the argument before the District Court on the issue of negligence was directed toward the application of the Jones Act, for the purposes of this appeal, the appellee is arguing only that part of the negligence action based upon the cause of action historically reserved for persons working aboard vessels. *The Max Morris* (supra); *Pope & Talbot, Inc.* v. *Hawn* (supra).

As recently as *The Kermarec* v. *Transatlantique,* 358 U.S. 625, 79 S. Ct. 406, 3 L. ed. 2d 550 (1958), the Supreme Court reiterated its position on this point and held, at page 632:

> ". . . We hold that the owner of a ship in navigable waters owes to all who are on board for purposes not inimical to his legitimate interests the duty of exercising reasonable care under the circumstances of each case."

The appellee, if injured aboard a vessel owned by a third party, would have an action against such a third party owner based upon negligence and the failure to exercise due care. This is one of his traditional remedies of the sea.

In *Reed* v. *S. S. Yaka* (supra), 373 U.S. 410, 83 S. Ct. 1349, 10 L. ed. 2d 448, the Court stated the proposition, at page 413:

> ". . . We further held that the Longshoremen's and Harbor Workers' Act was not intended to take away from longshoremen the traditional remedies of the sea, so that recovery for unseaworthiness could be had notwithstanding the availability of compensation."

The Court further stated, at page 414:

> ". . . In making this argument, Pan-Atlantic has not pointed and could not point to any economic difference between giving relief in this case, where the owner acted as his own stevedore, and in one in which the owner hires an independent company."

As pointed out above, if the appellant had hired an independent company for its stevedoring, the appellee would be entitled to bring an action for negligence. What is the economic difference between giving relief in this case where the owner acted as his own harbor worker-employer?

Appellee submits that he is entitled to bring this action based upon negligence, which is one of the traditional remedies of the sea where a person is acting as a worker on a vessel.

CONCLUSION

In a review of the *Reed* v. *The Yaka* decision (supra), the January, 1964, Insurance Counsel Journal, 90, at page 95, states:

> "Longshoremen now have available as remedies direct action for damages against their employers for unseaworthiness or negligence where the employer operates the vessel on which the injury occurs. Logically, the same result should apply in cases of other shoreside personnel who sustain injury in the performance of their work traditionally done by seamen, on board a ship operated by their employer."

It is submitted that this summary is a correct statement of the law.

The attempt of the appellant to explain away the *Reed* v. *The Yaka* decision (supra) as a third party action completely overlooks the humanitarian principle set down by the Court, as page 415, that the

> ". . . need for protection from unseaworthiness was neither more nor less than that of a longshoreman working for the stevedoring company. . . . 'All were subjected to the same danger. All were entitled to like treatment under the law.' "

The District Court found that the vessel was in nav-

igation and did warrant its seaworthiness, and that the appellee was engaged in activity traditionally performed by seamen. This decision of fact has ample evidence to sustain it and should not be disturbed by this Court.

Respectfully submitted,

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CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

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No. 21080

United States
COURT OF APPEALS
for the Ninth Circuit

PACIFIC INLAND NAVIGATION COMPANY, a corporation,

Appellant-Cross-Appellee,

v.

DELBERT A. COURSE,

Appellee-Cross-Appellant.

Appeal from the United States District Court for the District of Oregon

HONORABLE JOHN F. KILKENNY

APPELLANT'S REPLY BRIEF

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APPELLANT'S REPLY BRIEF

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Appellant reaffirms its position that the Longshoremen's and Harbor Workers' Compensation Act, 33 U.S.C. 901 *et seq,* is the exclusive remedy of a shorebased employee against his employer-shipowner for injuries sustained upon his employer's vessel.

EXCLUSIVE LIABILITY PROVISION OF THE ACT HAS NOT BEEN ABROGATED

In order to maintain his position in the case at bar, appellee is forced to the argument that *Reed* v. *SS YAKA,* 373 U.S. 410 (1963) abrogated the *exclusiveness of liability* of the Longshoremen's Act and the appellee's remedies against his employer are no longer limited by the plain language of the statute. It becomes immediately patent that appellee's position is untenable when the decision in *Reed* v. *SS YAKA* is properly analyzed.

For its decision in *Reed* v. *SS YAKA,* the majority of the Court relied upon its prior holdings in *Seas Shipping Co.* v. *Sieracki,* 328 U.S. 85 (1946), and *Ryan Stevedoring Co.* v. *Pan-Atlantic SS Corp.,* 350 U.S. 124 (1956). In *Sieracki, supra,* the Court held that the warranty of seaworthiness owed by a vesselowner to a seaman extended to a longshoreman in the face of the argument that section 905 of the Act limited the longshoremen to compensation. The Court said, at page 101:

> ". . . In other words, it is claimed that the remedies afforded by the longshoremen's legislation are exclusive of all other remedies for injuries incurred aboard ship, whether against the employer or others . . ."

The Court concluded that such a contention had no merit. It reasoned that Congress did not purport to limit the longshoremen's remedies against others who were not his employer. The Court continued, at page 102:

> "We may take it therefore that Congress intend-

> ed the remedy of compensation to be exclusive against the employer. See *Swanson* vs. *Marra Bros., Inc.,* . . . decided this day, 328 U.S. 1. But we cannot assume, in face of the Act's explicit provisions, that it intended this remedy to nullify or affect others against third persons. Exactly the opposite is true. The legislation therefore did not nullify any right of the longshoreman against the owner of the ship, except in the instance, presumably rare, where he may be hired by the owner."

Language of like effect is found in *Ryan Stevedoring Co.* v. *Pan-Atlantic SS Corp., supra,* at page 131:

> "The shipowner's action here is not founded upon a tort or upon any duty which the stevedoring contractor owes to its employee. A third party complaint is grounded upon the contractor's breach of its purely consensual obligation *owing to a shipowner* to stow the cargo in a reasonably safe manner. Accordingly, the shipowner's action for indemnity on that basis is not barred by the Compensation Act."

In light of the fact that the Court drew upon the teachings and limitations expressed in *Sieracki* and *Ryan,* it would seem strange indeed to conclude that the holding is inconsistent with the concept of *exclusiveness of liability* which was reaffirmed in those two cases, or that either of the three cases expresses a point of view foreign to the language of the statute.

In *Italia Societa Per Azioni di Navigazione* v. *Oregon Stevedoring Company, Inc.,* 376 U.S. 315 (1963), the Supreme Court made clear that its decision in *Reed* v.

SS YAKA, supra, did not change the rule that the Longshoremen's Act imposes exclusive liability on the shipowner-employer to its employee as distinguished from the contractual undertaking in *Ryan Stevedoring Co.* v. *Pan-Atlantic SS Corp., supra,* to the ship owner. At page 320, footnote 6, it is said:

> "If the stevedore is liable in warranty for supplying defective, injury producing equipment, of course, the provisions of the Longshoremen's and Harbor Workers' Compensation Act, . . . , are no bar to recovery. This question was fully resolved in *Ryan vs. Pan-Atlantic Corp.,* . . . 'The Act nowhere expressly excludes or limits a shipowner's right, as a third person, to insure itself against such a liability either by bond of indemnity, or the contractor's own agreement to save the shipowner harmless.' See also *Reed* vs. *Yaka,* 373 U.S. 410 . . ."

Mr. Justice Black (who authored the majority opinion in *Reed* v. *S.S. YAKA, supra*) in his dissenting opinion in *ITALIA, supra,* reaffirmed the *exclusiveness of liability* provision, saying at page 325:

> ". . . In *Halcyon Lines* v. *Haenn Ship Ceiling & Refitting Corp.,* 342 U.S. 282 . . . and *Pope & Talbot, Inc.* v. *Hawn,* 346 U.S. 406 . . ., we held that the system of compensation which Congress established in the Longshoremen's and Harbor Workers' Compensation Act as the sole liability of a stevedoring company to its employees prevented a shipowner from shifting all or a part of his liability to the injured longshoreman onto the stevedoring company, the longshoreman's employer."

Mr. Justice Black then explained the exception to this rule under the *Ryan* doctrine where there is a third

person involved and the employer by contract assumes a greater burden to that third person. Referring to *Reed* v. *YAKA, Supra,* (at page 325, footnote 2) he said:

> "*Reed* v. *YAKA,* 373 U.S. 410 . . ., held only that a longshoreman could bring a suit for unseaworthiness against a stevedoring company which chartered a ship and was the longshoremen's employer. In that case no issue as to an implied warranty of workmanlike service arose because the stevedoring company had agreed in any case to hold the shipowner harmless without regard to negligence . . . ."

Reed v. *SS YAKA, supra,* has left intact the employer's immunity from suit by his employees. The liability imposed upon the employer (Pan-Atlantic) was imposed on the same principle as the liability imposed on the employer in *Ryan, supra.* The employer, by the terms of the hold harmless agreement contained in the charter party, agreed to accept the responsibilities of a third party shipowner and for that reason alone was held liable.

GENERAL EXPRESSIONS OF HUMANITARIAN POLICY DO NOT SUPPORT THE CASE AT BAR

In support of his position appellee has extracted certain phrases from their context in *Reed* v. *SS YAKA, supra,* which cannot meet the facts of his case. He cites only the broad general language of the court's opinion without proper regard for the context in which the language appeared, without regard for the relationship of the parties involved or the issue before the court for decision.

The Supreme Court in *Osaka Shosen Line* v. *United*

States, 300 U.S. 98, cautioned against such practice in the following language, at page 103:

> *"It is a maxim, not to be disregarded, that general expressions, in every opinion, are to be taken in connection with the case in which those expressions are used. If they go beyond the case, they may be respected, but ought not control the judgment in a subsequent suit, when the very point is presented for decision. Cohens* v. *Virginia,* 6 *Wheat* 264, 399; *Humphreys Executor* v. *United States,* 295 U.S. 602, 626-627". (Emphasis supplied)

At first blush, it appears that some phrases used by the majority of the court do support appellee's claim against his employer, but the language fails him when it is viewed in its context.

Mr. Justice Black, for the purpose of establishing the reason for the decision, in broad general terms cited humanitarian principles as the basis for the warranty of seaworthiness found in *Sieracki, supra,* and then for the purpose of demonstrating the parallel of the employers in *Ryan, supra, and in SS Yaka, supra,* stated at page 414:

> "In making this argument, Pan-Atlantic has not pointed and could not point to any economic difference between giving relief in this case, where the owner acted as his own stevedore, and in the one in which the owner hires an independent company. In either case, under *Ryan,* the burden ultimately falls on the company whose default caused the injury."

The case holds only that a longshoreman may assert a cause of action against his stevedore employer which

was also the charterer of the vessel. The liability imposed upon the employer (Pan-Atlantic) was not imposed as a result of any obligation it owed to *Reed* as an employer, but was imposed upon Pan-Atlantic as a result of its assuming the shipowners' responsibilities by the terms of the hold harmless agreement.

The Court viewed the charter party arrangement as an attempt to insulate the shipowner from liabilities it would have had sans the contractual arrangement. But, by the very terms of the charter party, the stevedore employer assumed the shipowner's liabilities and was therefore, held liable.

There is no evidence that appellant has done anything other than repair its own tugboat, accepting the responsibilities that flowed upon it as a single entity. Appellant has not attempted to enter into any contractual arrangements with third parties to change its liabilities.

Appellant here is not contesting an action asserted against it by virtue of its having voluntarily assumed the responsibilities of a third party. The appellant here is contesting a claim being made directly by an employee and therefore seeks the protection of the *exclusive liability* provisions of the Longshoremen's and Harbor Workers' Compensation Act to which it is entitled.

FACTS PRESENTED IN CASE AT BAR WERE DECIDED AGAINST APPELLEE'S POSITION

The question for decision in the case at bar was before the Supreme Court in the case of *Pennsylvania Railroad Co.* v. *O'Rourke,* 344 U.S. 334 (1953).

O'Rourke was a *railroad brakeman* who brought an action under the *Federal Employer's Liability Act,* 45 U.S.C. Sec. 51, and *Safety Appliance Acts,* 45 U.S.C. Sec. 1, for injuries sustained when he released a defective handbrake on a freight car which was aboard a car float on navigable waters. A summary judgment was granted, dismissing the complaint. The Second Circuit reversed the judgment. The Supreme Court reversed the Second Circuit and held that the Longshoremen's and Harbor Workers' Compensation Act applied to the exclusion of the Federal Employer's Liability Act, saying at page 338:

> "We need not, however, in this case, determine whether the car float is a 'boat' that should be regarded as in substance a part of the railroad extension. . . . It is clear that whether or not the boat is an extension of the railroad under the Liability Act is immaterial. The later Harbor Workers' Act by sections 903 (a) and 905 covered such injuries on navigable waters and made its coverage exclusive. *Nogueira* v. *N.Y.N.H. and H.R. Co., supra,* at page 130-131. . . ."

The holding of *O'Rourke* has been followed in the following cases: *Mach* v. *Pennsylvania Railroad Company,* 198 F. Supp. 469 (W.D. Pa. 1958); *Caldaro* v. *Baltimore and Ohio Railroad Company,* 166 F. Supp. 833 (E.D. N.Y. 1956); *West* v. *Erie Railroad Company,* 163 F. Supp. 879 (S.D. N.Y. 1958); *Scrinko* v. *Reading Co.,* 117 F. Supp. 603 (D. N.J. 1954). In each of these decisions the plaintiff was a railroad employee seeking a recovery under *F.E.L.A.* for injuries received in a maritime employment. In each case the plaintiff was en-

gaged in a task which was at these times considered to be "traditional seaman's work." In each case the Courts held that the plaintiff's exclusive remedy was pursuant to the Longshoreman's and Harbor Workers' Compensation Act.

If the Longshoremen's and Harbor Workers' Compensation Act will immunize a railroad owner from a cause of action granted to its employees by an Act of Congress, then certainly the same Act should insulate a shipowner-employer whose liability to its employees arises not through an Act of Congress but through the admiralty "common law."

Rationale of Reed v. S. S. Yaka Is Inapposite to a Ship Repairman

Assuming arguendo, that *Reed* v. *S. S. Yaka, supra,* is authority to permit a suit by a longshoreman against his employer-shipowner, appellant argued in a pretrial motion (Appendix, pp. 2-2c) and in its opening brief that the privilege would not extend to a ship repairman. It was there noted that the rationale of the decision in *Reed* v. *S. S. Yaka, supra,* was to give a longshoreman equal remedies whether he is employed by an independent contractor or the shipowner. It was there pointed up that the risks which befall the longshoremen attendant upon the transient nature of their employment were not shared by ship repairmen.

It was also pointed up that the stevedoring business is not a business that requires a great deal of material, equipment or facilities; that a stevedore was primarily

a labor contractor obtaining its employees from a central hiring hall only as it needs them. In contrast, a ship repairer is required to have a substantial investment in property, with yard facilities, up-to-date special machinery and equipment and usually a drydock.

There is not, therefore, the incentive to go into the ship repair business simply to escape third party recoveries by employees, as there might be for a ship owner to go into the stevedore business (Appendix, pp. 2b, 2c).

Vessel Not in Maritime Service

West v. *United States,* 361 U.S. 118 (1959) is not authority for the proposition that a vessel must be in the mothball fleet undergoing repairs in order not to warrant her seaworthiness, an appellee suggests. The case stands for the proposition that any vessel which is not in maritime service, *for whatever reason,* does not warrant her seaworthiness. In holding that the MARY AUSTIN undergoing general repairs did not warrant her seaworthiness the Court stated at page 121:

> ". . . On the other hand, the vessels involved in the cases depended upon by petitioners were, at the time of injury, . . . instead of undergoing general repairs, were in active maritime service. . . ."

The Court in *West, supra,* laid down three tests for determining whether or not a vessel is in maritime service, saying that the emphasis should be upon the vessel's status, the extensive nature of the work to be performed, and on the pattern of repairs. By the "status of the ves-

sel," the Court refers to the situation where the vessel has been formally retired from navigation as in *Roper* v. *United States,* 368 U.S. 20 (1961), and also where the vessel is physically unable to participate in maritime commerce as in *N.Y. & N.J. Pilots* v. *Halecki, Admx.,* 358 U.S. 613 (1959) and in *Gill* v. *Tancred* (D.C. N.D. Cal., 1957), 1958 A.M.C. 670. The "extensive nature of the work to be performed" has reference to the situation where the repairs require the services of a specially equipped repair yard as in *West* itself, and in *Union Carbide Corp.* v. *Goett, Admx.* (4 Cir. 1959), 278 F.2d 319. The phrase "pattern of repairs" is addressed to the question of whether or not the work being performed upon the vessel was customarily done by the ship's crew, as in *Berryhill* v. *Pacific Far East Line* (9 Cir. 1956), 238 F.2d 385 and *Halecki, Admx., supra.*

In the instant case the tug BANNOCK was docked at appellant's repair yard (Tr. 130). Her motive power was inoperative and she drew her electrical power from shore-side facilities (Tr. 13, 89, 124). In short, she was not a vessel capable of engaging in maritime service.

The repairs required the use of specialized equipment which was not carried aboard the vessel (Tr. 131, 132).

Besides, having both main engines dismantled, her rudders, drive shafts, and propellors were to be removed and replaced (Tr. 132, 133, 134) which appellee admitted was not work traditionally performed by the crew (Tr. 126).

The cases cited by appellee add nothing to his con-

tentions. It goes without saying that a vessel formally withdrawn from navigation is not in maritime service as was the SS HARRY LANE in *Roper* v. *United States, supra.*

In *Lawlor* v. *Socony-Vacuum Oil Co.* (2 Cir. 1961), 275 F.2d 599, the Court found that the work being performed was performed customarily by the crew and too, the repairs were minor as said by the Court at page 561:

> ". . . The work called for by the contract . . . was the usual large number of miscellaneous items including the finding of cracks and leaks in the tanks and repairing them. . . ."

The repairs in *Pollock* v. *Standard Oil Company of California,* (Cal. D.C. of App. 1st D., 2nd Div. 1965) 42 Cal. R. 128 were said by the Court to be the same as in *Lawlor* v. *Socony Vacuum, supra.*

The tug BANNOCK meets all three tests enunciated in *West* v. *United States, supra,* and should not be held to warrant her seaworthiness.

Negligence Count Properly Stricken

On a pretrial motion to dismiss the libel or in the alternative to dismiss the negligence count, the whole of appellee's argument was directed to a cause of action under *The Jones Act,* 46 U.S.C. 688. Not once did he intimate that he was asserting a claim under the general maritime law. Judge East properly dismissed the count under the authority of *Swanson* v. *Marra Bros., Inc.,* 328 U.S. 1 (1946). During the course of his opinion, Judge East told appellee how to affect such a claim, but appel-

lee obviously preferred not to do so. Appellee did not assert such a claim and ought not now to be heard to say that he did.

Be that as it may, appellee does not have a tort claim under the general maritime law. At common law "fellow servant negligence" was a defense and until the *Jones Act, supra,* did away with the defense as to members of the crew, negligence of a fellow employee was a defense as to all employees including crew members under the general maritime law. *The Osceola,* 189 U.S. 158 (1903); *The West Kader* (9th Cir. 1923), 1923 A.M.C. 655. *The Jones Act, supra,* does not apply to ship repairmen. *Swanson* v. *Marra Bros., Inc., supra.* All hands aboard the tug BANNOCK were appellee's fellow servants. To grant to appellee a cause of action on a tort theory would be to grant him a remedy against a shipowner not enjoyed by an employee working for an independent contractor.

One in the employ of an independent contractor whose injury was caused by the negligence of a "fellow servant" cannot maintain an action against the shipowner unless the negligence of the "fellow servant" renders the vessel unseaworthy. And even in that case, the cause of suit must be predicated upon the unseaworthiness of the vessel and not upon a negligence theory.

Appellee's contention serves to further point up the absurd results which would follow if he is allowed to prevail upon this appeal. To attempt to apply the rationale of *Reed* v. *SS YAKA, supra,* in the unique fac-

tual situation of that case to the case at bar would plainly distort the congressional intent of equality of treatment for all employees under the Longshoremen's and Harbor Worker's Compensation Act.

CONCLUSION

Appellant has no liability to appellee because the courts are not free to rewrite the provisions of the Longshoremen's and Harbor Workers' Compensation Act and make what was intended as an immunity from suits and damages no immunity at all.

The fact is that *Reed* v. *SS Yaka, supra,* involved a vessel operated by the employer but owned by a third person. It was on these facts, in accord with the *Ryan* doctrine, that the Supreme Court held the employer liable because the employer had voluntarily agreed to assume the obligations of the shipowner, the third party.

The reason for the holding in *Reed* v. *SS Yaka, supra,* was to foreclose the stevedoring employers from entering into contractual arrangements for the sole purpose of destroying the longshoremen's rights against the shipowner. Certainly it was not intended to impose liability contrary to the provisions of the Longshoremen's and Harbor Workers' Compensation Act upon a tugboat owner which has traditionally repaired its own vessels.

The facts of this case are not novel. They were before the Supreme Court in *Pennsylvania Railroad Co.*

v. *O'Rourke, supra,* and the issue was decided against appellee's contentions.

Respectfully submitted,

GRAY, FREDRICKSON & HEATH
FLOYD A. FREDRICKSON
EUGENE D. COX
Of Proctors for Appellant

CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this brief, we have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit and that in my opinion, the foregoing brief is in full compliance with those rules.

EUGENE D. COX
Of Proctors for Appellant

APPENDIX

Summary of Argument on Motion for Summary Judgment

MR. FREDRICKSON: If the Court please, on behalf of Respondent Pacific Inland Navigation Company we would move at this time for a summary judgment in favor of Pacific Inland Navigation Company against Mr. Delbert Course.

We rely, your Honor, on the Biggs case, decided by Judge Hoffman in the Eastern District of Virginia, which is set forth in the memorandum which we have previously filed with the Court.

It is simply a question, your Honor, whether or not this man has his compensation benefits under the Longshoremen and Harbor Workers' Act or is entitled to recover in this court. All of the evidence relied upon in the Biggs case is before your Honor, and we have marked as an exhibit a certificate of insurance which shows that he had coverage under the Longshoremen and Harbor Workers' Act. I am sure there will be no dispute. Mr. Course has received compensation under the Longshoremen and Harbor Workers' Act.

Further in the pretrial order it sets out that Mr. Course is a marine electrician, not a longshoreman, a shoreside marine electrician, so that all of the pertinent and authoritative facts are before your Honor at this time so far as ruling on the motion for summary judgment is concerned.

If I might, I would like to mention to your Honor why I think the Biggs case is correct. As your Honor knows, a longshoreman, a regular longshore-

man, works daily for different employers. They are hired out of a central hiring hall. I am sure your Honor knows this from the many cases that you have tried. They work one day for Brady Hamilton, and the next day for American Mail Line and a third day for Portland Stevedore Company. Many times, as your Honor knows, the man doesn't even know who employs him, and quite properly so, because his employment is through this central hiring hall. He works one day for one employer and one day for another.

Now, in that connection, the information put out in this very beautiful booklet, "Men and Machines," by the P.M.A. and I.L.W.U. states that these men go out for different employers out of a central hiring hall, so that they do have permanent or semipermanent steady work. It is something that has been of benefit, I take it, to the whole industry.

Now, this man who goes out daily and works a different employer, says, "It is ridiculous if I work for Portland Steve, and the next day I work for American Mail Line, and it turns out that American Mail Line are on some other benefits or I don't have the same rights against American Mail Line that I would have against Portland Stevedoring Company."

The authority of Reed v. YACA, in my opinion, held that the warranty of seaworthiness would extend to a man who is working, in effect, for his employer who also owns or bareboat charters the vessel on which he is employed.

Now, contrasted with that situation is the employment of Mr. Course. As his deposition will indicate, he worked for about a year and a half for Pacific Inland Navigation Company. They maintained

a permanent or semi-permanent shipyard staff at their facilities. It is quite unlike the day-to-day change of employer that you have with a longshoreman. Mr. Course was, in effect, a regular employee of his employer, which I think is the distinguishing characteristic and explains the reasoning and basis for the Biggs case. Furthermore, Reed v. YACA says a shipowner should not be allowed to put up an economic barrier by going into the stevedoring business.

As your Honor knows, the stevedoring business is not a business that requires a great deal of material or equipment or facilities. In effect, a stevedore is simply a labor agent. He gets his employees out of a central hiring hall, brings them down to the ship, and he sells services primarily. I think you can distinguish that from the repair yard facility, where you are required to have a substantial investment in property, with yard facilities and equipment required to repair vessels.

The point I would like to make is that there is not the incentive to go into the shipyard business simply to escape third party recoveries by your employees, as there very well might be with the longshore situation, when you really only need an office or two, and you get some walking boss again out of the central hiring hall.

I think that these are the pertinent facts which explain the Biggs case, and which distinguish a longshoreman from a man, a marine electrician, who is employed by a ship repair yard, as Mr. Course was.

THE COURT: Thank you.

MR. GREEN: If the Court please, I am not sure how much of the historical background I should give to the Court. I am sure the Court is aware —

THE COURT: I think I am familiar with that.

MR. GREEN: All right. I would like to state to the Court the fact that we do not have to guess whether or not other courts have included repairmen, electricians or painters. In a case cited in the memorandum from the Fourth Circuit Court, Socony-Vacuum Oil against Lawlor, 275 Fed. (2d) 599, that is a case where the ship was in for an annual overhaul and involved quite extensive sums of money, your Honor, and the man injured was in no way related to the stevedore. He was a man supervising other persons on the job doing the repairs. And that court has held that, since this was not out of navigation and simply to be considered a dead ship, this man was protected by the same rules and rights as to unseaworthiness of the vessel as would a longshoreman.

The Supreme Court has held specifically a nonlongshoreman would have the protection of unseaworthiness in a case where the employers were separate. Then the only differentiation here is where the employer of this man is the same person that owns the ship.

In Reed v. YACA (sic) it just says that makes no difference in a longshore situation.

Admittedly, there has been no Supreme Court decision that has said whether or not it would make a difference, the fact that there was ownership of the ship and ownership of either the stevedore company or repair yard, if it was a nonlongshoreman. No Supreme Court decision has said that as yet.

Just by logic, there has been no other distinction made by the Court unless the ship is dead. That seems to be the primary distinction.

I would like to point out to the Court—it is not in the memorandum, but I will say on the record as an officer of the Court that from a telephone call this morning we found that the Biggs case is now being argued as of today in the Court of Appeals, and the lawyers there tell us that it roughly will be three months before the Court of Appeals will determine whether or not the District Court was correct.

I would like to point out one further thing in the Biggs case, your Honor. If the Court has had an opportunity to read it, you will notice that the Court was extremely unhappy, I think with the plaintiff's attorney, because that attorney had processed his claim through the Virginia compensation system, not the Federal, where he had to swear on a number of occasions under oath that he was not a seaman, had none of those rights, and so forth, and then was proceeding on this unseaworthiness doctrine.

That is not the case here. We have not sworn we have done anything other than exactly what he did. He was an electrician, and he was working on board ship at this particular time. We believe he has a right, just as a longshoreman, to obtain compensation benefits under the Longshoremen and Harbor Workers' Act, and if there is unseaworthiness of the vessel he has either a right to libel the vessel in rem and file an action or libel the vessel in personam —

THE COURT: The motion for summary judgment is denied.

No. 21080

United States
COURT OF APPEALS
for the Ninth Circuit

PACIFIC INLAND NAVIGATION COMPANY,
a corporation,

Appellant Cross-Appellee,

v.

DELBERT A. COURSE,

Appellee Cross-Appellant.

Appeal from the United States District Court for the District of Oregon

HONORABLE JOHN F. KILKENNY, Judge

BRIEF OF AMICUS CURIAE
COLUMBIA RIVER TOWBOAT ASSOCIATION

FILED

SEP 1 1966

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HONORABLE JOHN F. KILKENNY, Judge

BRIEF OF AMICUS CURIAE COLUMBIA RIVER TOWBOAT ASSOCIATION

With consent of the parties and pursuant to Rule 18(9) of this Court the Columbia River Towboat Association presents this brief as amicus curiae. It is directed to the single question of whether or not Section 5 of the Longshoremen's & Harbor Workers' Compensation Act, C509, #5, 44 Stat. 1426, 33 U.S.C. #905, precludes

appellee, Delbert Course, a harbor worker, from maintaining his libel *in personam* against his employer, the appellant, Pacific Inland Navigation Co. for damages arising from personal injuries which he sustained while working aboard his employer's tug, BANNOCK. The pertinent portion of Section 5 of the Act reads:

> "The liability of an employer prescribed in Section 904 of this title shall be exclusive and in place of all other liability of such employer to the employee, . . . otherwise entitled to recover damages from such employer at law or in admiralty on account of such injury or death . . ."

While the above language in Section 5 of the Longshoremen's Act clearly bars the *in personam* action of Delbert Course against his employer the Supreme Court by broad language rather than its holding in *Reed* v. *Yaka* (1963), 373 U.S. 410, so muddied the waters as to persuade the district court below that it was required to ignore or consider repealed the unequivocal language of Section 5. In this case a pre-trial motion to dismiss was denied. Upon trial, Delbert Course recovered judgment resulting in appeal by his employer and our appearance as amicus curiae.

Unless reversed the judgment of the District Court will have a harsh and incongruous effect upon the tug boat industry.

The Columbia River Towboat Association is comprised of fourteen tugboat operators, including Pacific Inland Navigation Co., who have been for many years engaged in towing and transporting cargoes on the Co-

lumbia and Willamette Rivers.[1] Each operator, whether large or small, employ shop repairmen, welders, and marine electricians precisely, as did Pacific Inland Navigation Co. employ Delbert Course. These employees are employed regularly on a year around basis. They work primarily ashore but as occasion requires they board their employer's vessels to repair, maintain or overhaul them. None are members of a crew and none do longshoremen's work or are employed through a hiring hall for specific jobs as are longshoremen. These tugboat operators, as employers, for years have carried insurance pursuant to the Longshoremen's Act to cover these employees when working spasmodically, at best, on navigable waters.

Before presenting our analysis of the *Yaka* case, we believe the pointing out of the harsh and incongruous results that will beset the tugboat industry if Delbert Course is permitted to recover in this case, can best demonstrate why the Supreme Court could never have intended to establish a precedent for a direct action as is here involved.

We agree with Mr. Justice Harlan in his dissent in *Yaka* that the following statement by Mr. Justice Black in his dissent in *Ryan Stevedoring Co.* v. *Pan-Atlantic*

---

[1] *Atlas Tug Service,* Longview, Washington; *Brusco Towboat Co.,* Cathlamet, Washington; *Columbia Pacific Towing Corporation,* Stevenson, Washington; *Diesel Towing Co.,* Portland, Oregon; *Knappton Towboat Co.,* Portland, Oregon; *The Mirene Co.,* Portland, Oregon; *Pacific Inland Navigation Co.,* Vancouver, Washington; *Ramona Towboat Co., Inc.,* Portland, Oregon; *Shaver Transportation Co.,* Portland, Oregon; *Shepard Towing Co.,* St. Helens, Oregon; *Smith Tug & Barge Co.,* Rainier, Oregon; *Tidewater Barge Lines, Inc.,* Portland, Oregon; *Western Transportation Co.,* Portland, Oregon; and *Willamette Tug & Barge Co.,* Portland, Oregon.

SS Corp (1956), 350 U.S. 124 states as concisely and as accurately as any the statutory design of the Longshoremen's Act:

> "Congress weighed the conflicting interests of employers and employees and struck what was considered to be a fair and constitutional balance. Injured employees thereby lost their chance to get large tort verdicts against their employers, but gained the right to get a sure, though frequently a more modest, recovery. However, Sec. 33 did leave employees a chance to recover extra tort damages from third persons who negligently injured them. And while Congress imposed absolute liability on employers, they were also accorded counterbalancing advantages. They were no longer to be subjected to the hazards of large tort verdicts. Under no circumstances were they to be held liable to their own employees for more than the compensation clearly fixed in the Act. Thus employers were given every reason to believe they could buy their insurance and make other business arrangements on the basis of the limited Compensation Act liability."

From the act as epitomized by Mr. Justice Black it appears that it was designed to give the harbor worker at best, one bite out of two apples; not two bites out of the same apple. He could for certain get a small bite from the apple of his employer, and then if the situation permitted, try for a larger bite from an apple of a third person. Here, Delbert Course has already taken two bites from his employer's apple. It cannot be done if plain language of Congress means anything.

If Delbert Course, after receiving full benefits under

the act, can collect a further $12,588.08 from his employer then the primary benefit of the Longshoremen's Act for the employer has gone out the window. It is no answer to say that by some theory of set-off the employer can deduct compensation paid under the act from the larger judgment because the *quid pro quo* for the employer in the first instance to provide compensation upon a no fault basis has been taken away.

This Court has long held that the Longshoremen's Act is to be interpreted so as not to be unfair to either the employee or employer. *Pacific S. S. Co.* v. *Pillsbury* (D. Ct., Calif., 1931), 52 F.2d 686 affirmed in (9 Cir. 1932) 56 F.2d 79. What could be more unfair than to require the employer to subsidize his employee by paying benefits in order to enable him to later sue for more money than the Act requires to be paid to the employee? Yet, the cruelest thing of all is that the tugboat-employer cannot abandon the Act and take his chances in a court of law or admiralty as before the Act. Section 5 provides that should the employer give up paying insurance premiums to "secure payment of compensation" to his employee, then his employee can elect to either claim under the Act or sue him in any court of law or in admiralty where all of the employer's traditional defenses, such as contributory negligence, are taken away from him. While the employee may elect the employer cannot. This might not be so bad, except the employer still cannot get out of the Act's clutches, as by Section 38 (33 U.S.C. #938) failure to secure payment of compensation subjects the employer to a $1,000 fine and one year in jail.

Atop of this, Section 44 (33 U.S.C. #944) requires the employer in certain cases to contribute to a trust fund for benefit of certain employees in general.

In short, if Delbert Course can sue his employer in law or in admiralty to recover damages either arising from causative negligence or causative unseaworthiness of his employer's vessel, then the once equitable Act has been transformed into a snare and a delusion for the employer—in this case the tugboat industry. If Section 5 of the Longshoremen's Act is to be emasculated by the judiciary, it could very well lead to a repeal or wholesale disregard of the Act. This would be a blow to the harbor worker, who at one time so much wanted a compensation act for industrial injuries, just as was furnished to his shore-based brethren by the various states.

Reed v. Yaka is clearly a third party case giving no real support for libel in personam by a harbor worker against his employer-tugboat owner.

The Supreme Court has consistently reminded both bench and bar that:

> ". . . general expressions, in every opinion, are to be taken in connection with the case in which those expressions are used. If they go beyond the case, they may be respected, but ought not to control the judgment in a subsequent suit, when the very point is presented for decision." *Osaka Shosen Line* v. *United States* (1937), 300 U.S. 98, 102; *Humphrey's Executor* v. *United States* (1935), 295 U.S. 602, 626.

With this as a criteria let us examine *Yaka* to determine

if its holding really supports Delbert Course in his direct *in personam* libel against his employer-tugboat owner.

To begin with, *Yaka* was pleaded and tried throughout three courts as: (1) a direct libel *in rem* by longshoreman Reed against the vessel YAKA, which was owned and claimed by Waterman Steamship Co.; and (2) a libel *in personam* by Waterman S.S. Co. against Pan-Atlantic S.S. Co., the bare-boat charterer of the YAKA, for breach of the latter's agreement contained in the bareboat charter to indemnify and save Waterman harmless from claims such as was being asserted by longshoreman Reed. At no time did Reed assert a direct claim of any kind against his employer, Pan-Atlantic. The case in every respect was typical of those sanctioned by the Court in *Ryan Stevedoring Co. v. Pan-Atlantic SS Co.*, (1956) 350 U. S. 124, except for the fact that in *Yaka* the stevedore happened also to be the operator of the YAKA as a bare-boat charterer which placed him in the status of owner *pro hac vice*. The framework of this litigation is ascertained by reading the District Court's opinion (183 F. Supp. 69), the Court of Appeals opinion (307 F.2d 203) as well as the Supreme Court's opinion (373 U. S. 410).

What happened in *Yaka* is that after the Court had granted certiorari to consider the question of whether or not an underlying personal liability was essential to support a libel *in rem* against a vessel, the Court determined to avoid that question as it saw under the facts a personal liability. The Court found two owners of the YAKA; Waterman as the true owner, who would be re-

quired to respond to Reed's libel *in rem,* lest its vessel be sold, and Pan-Atlantic as a second owner by operation of law, i.e. a bareboat charterer with the status of owner *pro hac vice*. For its theoretical purpose of furnishing a personal liability to support Reed's *in rem* claim it did not matter to the Court from whence it came. Since it was Waterman which really owned the vessel and would be required to respond to Reed's *in rem* libel, one would think if the *in rem* action was to be supported at all, it would have to be by Waterman's personal liability. However, Waterman had no personal liability as at time of Reed's injury the vessel was in control of Pan-Atlantic. To avoid this "sticky wicket" the Court, for its limited purposes, saw no reason why it could not use Pan-Atlantic's personal liability to underlay and support Reed's claim *in rem* against the vessel belonging to Waterman. This is exactly what it did.

As to Pan-Atlantic, this case was routine. It was only Waterman and not Reed who made claim against Pan-Atlantic in a libel *in personam* for breach of a maritime contract to indemnify. The Court had held in *Ryan* that Section 5 of the Longshoremen's Act was no procedural bar to such a right-over, inasmuch as the party asserting the right-over was not the longshoreman himself. Absent a direct action against Pan-Atlantic by Reed, Section 5 of the Longshoremen's Act would not come into play and absent Section 5 there could be little doubt but what a bareboat charterer as owner *pro hac vice* would be liable to maintain a seaworthy ship for its seamen.

Holding in Yaka

Within the factual posture of this case it was relatively simple for the Court, without much explanation and without over-ruling prior decisions or voiding an Act of Congress, to hold in the very last sentence of its opinion written by Mr. Justice Black:

> "We conclude that petitioner was not barred by the Longshoremen's Act from relying on Pan-Atlantic's liability as a shipowner for the *Yaka's* unseaworthiness in order to support his libel *in rem* against the vessel."

As we see it, the above quoted last sentence is the only holding which the Court made, the only holding favorable to Reed which it could have made and a holding which cannot in any manner support Delbert Course in his *in personam* libel against his employer, who also happened to be the true owner of tug *BANNOCK*.

Our view of the limited holding in *Yaka* is precisely the view of the Court in *Robinson* v. *Lykes Bros. S. S. Co.* (Ct. App. La., 4 Cir., 1965) 170 So. 2d 243 where in a case the same as we have at bar, the Court rejected *Yaka* as sanctioning an *in personam* suit by a longshoreman against his employer-shipowner. After quoting the last sentence in the *Yaka* opinion as its holding (as above) the Court observed:

> "The Court was not called upon, and did not hold that an 'in personam' action could be brought by an injured longshoreman against his employer who was also the shipowner."

We concede there are broad statements in the Court's opinion speaking generally of situations beyond the facts of *Yaka,* which no doubt influenced the able trial judge to conclude that the Supreme Court was nullifying Section 5 of the Longshoremen's Act as a procedural bar to an employee such as Delbert Course to maintaining a direct libel in admiralty and *in personam* for damages arising from being injured while working aboard his employer's tugboat. Typical is the following language of the Court appearing directly above its limited holding:

> ". . . Pan-Atlantic relies simply on the literal wording of the statute, and it must be admitted that the statute on its face lends supports to Pan-Atlantic's construction. But we cannot now consider the wording of the statute alone. We must view it in the light of our prior cases in this area, like *Sieracki, Ryan,* and others, the holdings of which have been left unchanged by Congress.
>
> ". . . And *Ryan's* holding that a negligent stevedoring company must indemnify a shipowner has in later cases been followed and to some degree extended. In the light of this whole body of law, statutory and decisional, only blind adherence to the superficial meaning of a statute could prompt us to ignore the fact that Pan-Atlantic was not only an employer of longshoremen but was also a bareboat charterer and operator of a ship and, as such, was charged with the traditional, absolute, and nondelegable obligation of seaworthiness which it should not be permitted to avoid. We have previously said that the Longshoremen's Act 'must be liberally construed in conformance with its purpose and in a way which avoids harsh and incongruous

results.' We think it would produce harsh and incongruous results, one out of keeping with the dominent intent of Congress to help longshoremen, to distinguish between liability to longshoremen injured under precisely the same circumstances because some draw their pay directly from a shipowner and others from a stevedoring company doing the ship's service. Petitioner's need for protection from unseaworthiness was neither more nor less than that of a longshoreman working for a stevedoring company. . ."

The Court's opinion, including the above quoted language, brought a seething dissent by Mr. Justice Harlan joined in by Mr. Justice Stewart, which in effect accused the Court of exceeding its jurisdiction by judicially repealing a plain and valid act of Congress. The broad language of the Court gives some basis to the charge of the dissenters; however, the holding of the Court does not. We prefer to argue to this Court that the holding in *Yaka* is in keeping with *Ryan* and Section 5 of the Longshoremen's Act and is not, as the dissenters say, — a "holding that a longshoreman may recover from his own employer for injuries suffered in the course of employment" and that the Court "has effectively 'repealed' a basic aspect of the Longshoremen's and Harbor Workers' Compensation Act."

To us, it is inconceivable that the Court would intentionally ignore or trod upon valid Congressional action. To our way of thinking such would be tantamount to treason to a government so firmly fixed as one of law and not of men. Our view of *Yaka* as here ex-

pressed squares completely with *Ryan, Sieracki* and other decisions of the Supreme Court, none of which have judicially repealed Section 5 of the Longshoremen's Act.

The Ryan Case

In *Ryan* the Court fashioned a new concept of a right-over for the shipowner against the stevedore and in doing so walked a tight rope. On one side of the tight rope was *Halcyon Lines* v. *Haenn Ship Ceiling & Refitting Corp.* (1952) 342 U.S. 282 wherein the Court refused to solve the "maritime triangle" by violating the common law rule against contribution by co-tort-feasors. On the other side was Section 5 of the Longshoremen's Act which prohibited the longshoreman from suing his employer at law or *in admiralty*. Affirming the validity and its clear understanding of Section 5 of the Longshoremen's Act, but going around it by fashioning a right-over in contract (express or implied-in-fact) the Supreme Court in *Ryan* held:

> "While the Compensation Act protects a stevedoring contractor from actions brought against it by its employee on account of the contractor's tortious conduct causing injury to the employee, the contractor has no logical ground for relief from the full consequences of its independent contractual obligation, voluntarily assumed to the shipowner, to load the cargo properly. (citing authorities)."

It would seem to us that the Court in *Yaka* also endeavored to walk a tight rope just as it did in *Ryan*. It did not strike down Section 5 but avoided it as it had

already been construed in *Ryan* as strictly a procedural bar to direct actions such as Delbert Course has pursued in the case at bar. This did not, however, frustrate the Court in furnishing an underlying personal liability to support Reed's *in rem* action against Waterman any more than taking a personal liability of Pan-Atlantic to maintain a seaworthy ship to support the Waterman liability. There is no contradiction in saying that while Pan-Atlantic owed a duty to furnish a seaworthy ship to "seaman" Reed he could not sue Pan-Atlantic directly for breach of such duty. After all, the duty was owed to all seamen. Reed happened to be a shore-based "super-seaman" in the sense that unlike the sea-going seaman he had the benefits of compensation under the Longshoremen's Act in lieu of a direct cause of action at law or in admiralty against his employer. Just because Reed in *Yaka* was successful in his indirect approach by suing *in rem* a vessel owned by a third party, Waterman did not mean he could have sued his employer, Pan-Atlantic should it have happened (which it did not) that Pan-Atlantic owned the vessel. The finding of an underlying duty that can be availed of by some and not others is not an uncommon principle of law. One of many examples is found in *Kesler* v. *Department of Public Safety* (1962) 369 U.S. 153, 170 where the Supreme Court held that while a discharge in bankruptcy prevented a judgment creditor from collecting a judgment from a debtor it did not extinguish or remove all traces of the debt from the debtor so as to prohibit the State of Utah under a safety statute from insisting that the discharged debt be satisfied before

the debtor's driver's license be re-instated. Considering Mr. Justice Black's dissent in *Ryan* and his concise exposition of the Longshoremen's Act therein, it is difficult for us to believe that when he spoke for the Court in *Yaka,* he intended any more than making the limited holding as set forth in the last sentence of the Court's opinion.

The Sieracki Case

As for *Seas Shipping Co.* v. *Sieracki* (1946) 328 U.S. 85, the Court held that a longshoreman was entitled to be assured of a seaworthy ship even though, like true seamen, the longshoreman was not employed by the shipowner. Even in that early case, the Court recognized that Section 5 of the Longshoremen's Act (33 U.S.C. #905) would bar a direct action should the shipowner also be the longshoreman's employer. Mr. Justice Rutledge, speaking for the Court at page 102 stated:

> "We may take it therefore that Congress intended the remedy of compensation to be exclusive as against the employer. See *Swanson* v. *Marra Brothers, Inc.,* ante p. 1); 33 U.S.C. #905. But we cannot assume, in face of the Act's explicit provision, that it intended this remedy to nullify or affect others against third persons. Exactly the opposite is true. *The legislation therefore did not nullify any rights of the longshoremen against the owner of the ship, except possibly in instance, presumably rare, where he may be hired by the owner. The statute had no purpose or effect to alter the stevedore's rights as against any but his employer alone.*" (emphasis added)

The Swanson Case

And, of course, in *Swanson* v. *Marra Bros.* (1946) 328 U.S. 1, the longshoreman was denied a direct action against his employer-shipowner. The case turned on more than the fact that the longshoreman was not a member of a crew. Mr. Justice Black announced the opinion of the Court by Mr. Chief Justice Stone. At page 6 he stated:

> ". . . The liability of employers to pay the prescribed compensation is, by #905, made 'exclusive and in place of all other liability of such employer to the employee' his legal representative and any other person entitled to recover damages 'at law or in admiralty' from the employer for the injury or death. . . ."

The O'Rourke Case

Ten years after *Swanson* v. *Marra Bros.,* supra, came another fundamental decision of the Supreme Court in *Pennsylvania Railroad Co.* v. *O'Rourke* (1953) 344 U.S. 334. There a railroad employee was injured while releasing a hand brake on a freight car while he was in the process of unloading the freight car from a carfloat owned and operated by his employer. He sued his employer as authorized by F.E.L.A. The Pennsylvania Railroad defended by asserting that the railroad employee was injured while afloat on navigable waters and hence was a harbor worker and that because of Section 5 of the Longshoremen's Act he was barred from suing his float owner-employer. The Court agreed with the railroad and dismissed the suit. In doing so it stated:

". . . The exclusive coverage of Nos. 903, 905 extends to an employee of an employer, made liable by No. 904, when he is injured, in the course of his employment, on navigable water. The Court of Appeals, we think, is in error in holding that the statute requires, as to the employee, both injury on navigable water and maritime employment as a ground for coverage by the Compensation Act."

In view of the *Ryan, Sieracki, Swanson* and *O'-Rourke cases, supra,* it should be evident that when the Supreme Court in *Yaka* stated:

". . . But we cannot now consider the wording of the statute alone. We must view it in the light of our prior cases in this area, like *Sieracki, Ryan,* and others, the holdings of which have been left unchanged by Congress."

the Supreme Court had reference only to not permitting any "paycheck arrangements" had with a longshoreman to frustrate the third party and right-over system with which it was confronted in *Yaka,* and which it had fashioned in *Ryan.* The Supreme Court did not say in *Yaka* that a longshoreman could sue his employer *in personam* for causative unseaworthiness or causative negligence in spite of Section 5 of the Longshoremen's Act, if his employer (as in *O'Rourke* and *Swanson*) happened also to own the vessel upon which he was injured.

Congressional Action and Non-Action

Further support for this view of the language in *Yaka* is found in the language itself. As stated by the

Court, its interpretation was influenced by lack of Congressional reaction to the Court's decisions such as *Sieracki* and *Ryan.* There has been no Congressional reaction to change or modify the shipowner's right-over as fashioned in *Ryan.* However, in 1959 Section 33 of the Longshoremen's Act (33 U.S.C. #933) was amended to give the longshoreman better control of his third party claim so as to cure the reason for the fear which Mr. Justice Black had expressed in his dissent in *Ryan.* Of significance here is that at that time Congress in Section 33(a) not only clarified the third party action for the longshoreman but expanded the immunity of the employer from direct action to include person or persons in the employers employ. It also added a new sub-section "(i)" reading:

> "(i) The right to compensation or benefits under this chapter shall be the exclusive remedy to an employee when he is injured, or to his eligible survivors or legal representatives if he is killed, by the negligence or wrong of any other person or persons in the same employ. *Provided,* that this provision shall not affect the liability of a person other than an officer or employee of the employer." (As amended August 18, 1959, Pu. L. 86-171, 73 Stat. 391, 33 USC #933).

The unmistakable purpose of the new language in Section 33 was to immunize the "employee family" of the employer from damage suits brought by longshoremen at law or in admiralty by placing fellow employees of the injured longshoreman under the umbrella of the Longshoremen's Act along with the employer who had earlier been so immunized by Section 5 of the Act. In-

stead of impliedly permitting a longshoreman to sue *in rem* as a "third party" his employer's vessel it in effect broadened the immunization of Section 5 by insulating not only the employer but also fellow employees of the injured party from liability in damages to the injured party. *Bynum* v. *MORMACTEAL* (E.D. Pa., 1960) 188 F. Supp. 763; *Garland* v. *Alaska Steamship Co.* (D. Ct. Alaska, 1963) 217 F. Supp. 757. *Report of Secretary of Labor to the Senate on H.R.* 451, U. S. Code, Congressional and Administrative News, 1959 at page 2134.

In the summer of 1959 when H.R. 451 which amended Section 33 of the Longshoremen's Act became law, the Supreme Court had decided *Sieracki* (1946), *Ryan* (1956), *Weyerhaeuser S. S. Co.* v. *Nacirema Operating Co.* (1958), 355 U.S. 563 and was in the process of deciding *Crumady* v. *The Joachim Hendrick Fisser*, (1959), 358 U.S. 423. These cases all had to do with the fashioning of the shipowner's right-over against the stevedore and not any direct action by longshoremen against his employer or his vessel. So, when the Supreme Court in *Yaka* viewed Section 5 in the light of its prior cases — "*Sieracki, Ryan,* and others" it must have been referring to the above cases. And when it stated that its holdings have been left unchanged by Congress it must again have been refering to its holdings in the above cases as Congress had taken positive action in 1959 to amend Section 33 so as to broaden the insulating effect of Section 5. As a consequence we think it is sound for this Court to read and understand the language in *Yaka* in the light of the "right-over" phase of

the "maritime triangle" as was factually before the Supreme Court in *Yaka* and ignore, as unsound, any connotation that might suggest that the Supreme Court intended to sanction direct *in personam* action by employee against employer upon the excuse that the employer happened also to be the owner of the vessel upon which the injury occurred.

Furthermore, if the Court in *Yaka* had at all intended by its language to sanction direct action by a longshoreman against his shipowner-employer, it would have been required to strike down the holding in *Smith v. The MORMACDALE* (3 Cir., 1952), 198 F.2d 849, as that case was cited and relied upon in both the District Court and the Court of Appeals. It did not. In fact, in the Circuit Court of Appeals, when Judge Staley joined the dissent of Chief Judge Biggs to the Court's holding which was reversed by the Supreme Court, he noted:

> "I join Chief Judge Biggs in his conclusion in his dissent. I read his dissent as not disturbing *Smith* v. *Mormacdale,* 198 F2d 849 (C.A. 3, 1952) where the employer was also the shipowner."

It should be mentioned that *Smith* v. *MORMACDALE, supra*, relied heavily upon the reasoning in *Samuels* v. *Munson S.S. Line* (5 Cir., 1953), 63 F.2d 861. Both of these cases are precisely like the one at bar where Delbert Course has sued his employer-tugboat owner, except that they were *in rem* while his is *in personam.* Both of these cases would deny Delbert Course the remedy he here has sought.

This Court should follow the limited holding in Yaka and not its language in order to uphold a plain act of Congress and not accuse the Supreme Court of going beyond its jurisdiction.

We are aware that other district courts, i.e. *Herte* v. *American Export Lines, Inc.* (S.D. N.Y., 1964), 225 F. Supp. 703 and, of recent, the Court of Appeals for the Fourth Circuit in *Biggs* v. *Norfolk Dredging Co.* (4th Cir., 1966), 360 F.2d 360 have held that Section 5 of the Longshoremen's Act is no bar to an action such as that brought by Delbert Course. It has, we think come about by those courts refusing to cut with surgical precision into *Yaka* and discover what it actually held For example, the Fourth Circuit Court of Appeals in *Biggs* v. *Norfolk Dredging Co., supra,* never really understood what was precisely before the Supreme Court in *Yaka* as it erroneously observed of *Yaka*: "His employer, the ship's bareboat charterer—or her owner *pro hac vice*—intervened to defend the suit." We commend to this Court the opinion of the Fourth Circuit Court of Appeals for the State of Louisiana in *Robinson* v. *Lykes Bros. S.S. Co.* (1965), 170 So. 2d 243, as being more sound than the opinion of the Fourth Circuit of the U. S. Court of Appeals just mentioned.

Trying to look as objectively as possible at the problem which confronts this Court in this case, we see it stemming from the broad language in *Yaka* which goes beyond its actual holding. The broad language gives some support to the District Court while the holding does not. For this Court in this *in personam* case to

permit Delbert Course to sue his employer-tugboat owner it will have to conclude: (1) That the plain language of Congress does not forbid it; and (2) That, as claimed by the dissenters in *Yaka,* the Supreme Court ignored or repealed an Act of Congress and in order to do so not only exceeded its jurisdiction and the facts of the case but also impliedly reversed many of its prior and important decisions.

Confronted with a duty to follow holdings of the Supreme Court, as well as valid Congressional action, we urge that this Court be mindful of the principle mentioned in *Osaka Shosen Line* v. *United States* (1937), 300 U.S. 98 at 102 as previously mentioned and bear heed to the observation of the Court of Appeals for the Fourth Circuit in *Carey* v. *Foster* (4th Cir., 1965), 345 F.2d 772.

In this last cited case the Court was confronted with deciding whether a wife had an action at law for damages for loss of her husband's consortium. The Court was confronted by a most vexing statute of Virginia. It observed in respect to its own jurisdiction at page 777:

> "The Virginia statute, however it is read, has placed an insurmountable obstacle in the way of judicial accomplishment of a result judges might think best. Courts may overturn judicially fashioned rules. They may withdraw or modify rights they once thought deserving of recognition, and they may recognize new rights when such recognition seems necessary to achieve a harmonious result, justice and equality. *They may not reverse a legislative exercise of constitutional power,* and

> rarely can they erect a structure to match a legislative creature though they may think the legislature should have gone further than it did." (emphasis added)

Certainly, in the case at bar the plain language o[f] Section 5 of the Longshoremen's Act forbids Delber[t] Course to sue his employer-tugboat-owner. Both deci[-]sions prior and subsequent to *Yaka* forbid it. When th[e] Supreme Court speaks of interpreting the Longshoremen's Act so as to prevent harsh and incongruous re[-]sults it must have considered those results as they appl[y] to the employer-tugboat owner as well as to the employ[-]ee. From such point of view equal protection of law an[d] elementary fairness also forbids it. Until the Suprem[e] Court speaks otherwise within the framework of a cas[e] where it is required to make a holding, we submit tha[t] this Court should reverse the District Court on the ba[-]sis that Section 5 of the Longshoremen's Act prevent[s] appellee from suing *in personam* his employer-tugboa[t] owner.

Respectfully submitted,

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CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of his brief, I have examined Rules 18 and 19 of the Jnited States Court of Appeals for the Ninth Circuit, nd that, in my opinion, the foregong brief is in full ompliance with those Rules.

William F. White

No. 21081

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

HENRY ROY,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

On Appeal From the Judgment of the District Court of the United States, Southern District of California, Central Division.

APPELLANT'S OPENING BRIEF.

FILED

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No. 21081

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

HENRY ROY,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

APPELLANT'S OPENING BRIEF.

Statement of Jurisdiction.

This is a criminal action brought by appellee, the United States of America against the appellant, Henry Roy, for willfully attempting to evade and defeat a part of his Federal income tax liability for the calendar years 1958, 1959, and 1960, in violation of Section 7201 of the Internal Revenue Code of 1954, as amended. [Clk. Tr. pp. 2-5.]

Jurisdiction was present in the United States District Court of Southern California by reason of Title 18, United States Code, Section 3231, and Rule 18 of the Federal Rules of Criminal Procedure. On or about May 2, 1966, the United States District Court for the Southern District of California convicted the defendant on all three (3) counts as charged.

The appellant timely appealed to this Court. [Clk. Tr. pp. 27-28.] This Court has jurisdiction of the appeal under Title 28, United States Code, Section 1291, 1294(1), and Rule 37(a) of the Federal Rules of Criminal Procedure.

Specification of Errors.

The Court below erroneously entered the judgment of guilty and denied the appellant's motion for new trial or a judgment of acquittal for the following reasons:

1. The plaintiff erred in its use of the bank deposit method of computing the appellant's taxable income by reason of the fact that the plaintiff had not established the inadequacy and inaccuracy of the defendant's books and records—a condition precedent to employing an alternative method of computing taxable income—when the use of taxpayer's books and records was the most accurate manner for ascertaining defendant's taxable income.
2. The appellee failed to introduce sufficient evidence to sustain a finding of willfulness on the part of the appellant within the meaning of Title 26, United States Code, Section 7201.

Statement of the Case.

On April 7, 1965, appellant was indicted for violation of Section 7201 of the Internal Revenue Code of 1954 as amended. [Clk. Tr. pp. 2-5.] The indictment charged that appellant understated his taxable income by $81,887.60, $113,861.07, and $158,535.21 for the calendar years 1958, 1959, and 1960, respectively. This understatement, the indictment charged, resulted in an

additional Federal income tax liability for the above years in the amount of $52,206.39, $77,182.73 and $115,497.70. The alleged omitted income was determined by the Government on the bank deposit method of computing taxable income.

Appellant plead not guilty to all three (3) counts of said indictment and was tried by the United States District Court for the Southern District of California, sitting without a jury, on March 15, 16, and 17, 1966. The Court found the appellant guilty on all three (3) counts of the indictment. [Clk. Tr. p. 27.] Thereafter, the appellant timely moved for a new trial, or in the alternative for a judgment of acquittal. [Clk. Tr. p. 8.] These motions were denied by the Court. From this adverse decision, the defendant appeals to this Court.

The appellant contends that the evidence produced at the trial of this case was insufficient to sustain a judgment of conviction on all three (3) counts of the indictment, that there was insufficient evidence of willfulness within the meaning of Section 7201 of the Internal Revenue Code of 1954, and that the bank deposit method of computing taxable income was improper in these circumstances.

ARGUMENT.

I.

BANK DEPOSIT METHOD—BOOKS AND RECORDS.

A. Case Law.

(i) Holland Case.

The appellee erred in its use of the bank deposit method of computing appellant's taxable income for the reason that appellee had not established the inadequacy or inaccuracy of the defendant's books and records, which is a condition precedent to employing an alternative method of computing taxable income. The use of the defendant's books and records would have been the most accurate manner of ascertaining defendant's taxable income.

Prior to 1954 the case law was unclear when considering the use of circumstantial evidence to establish a tax deficiency, and the accompanying fraudulent intent. The circumstantial evidence was presented through recomputations of taxable income by use of the net worth and bank deposit methods. The conditions precedent to the use of those methods, and the evidentiary value of same, had been the object of court decisions which varied greatly in allowing the use of such evidence. The conflict was presumably resolved by the decision of the Supreme Court in *Holland v. United States* (1954), 348 U.S. 121, 75 S. Ct. 127. The Court first noted at pages 124, 125:

> "In recent years, however, tax-evasion convictions obtained under the net worth theory have come here with increasing frequency and left impressions beyond those of previously unrelated petitions. *We*

concluded that the method involved something more than the ordinary use of circumstantial evidence in the usual criminal case. Its bearing, therefore, on the safeguards traditionally provided in the administration of criminal justice called for a consideration of the entire theory.

. . .

In a typical net worth prosecution, the Government, *having concluded that the taxpayer's records are inadequate as a basis for determining income tax liability,* attempts to establish an 'opening net worth' or total net value of the taxpayer's assets at the beginning of a given year." (Emphasis added.)

The Court then considered the policy considerations on which its holding was based (pp. 125-126):

"Before proceeding with a discussion of these cases, we believe it important to outline the general problems implicit in this type of litigation. In this consideration we assume, as we must in view of its wide spread use, that the Government deems the net worth method useful in the enforcement of the criminal sanctions of our income tax laws. *Nevertheless, careful study indicates that it is so fraught with danger for the innocent that the courts must closely scrutinize its use.*

"One basic assumption in establishing guilt by this method is that most assets derive from a taxable source, and that when this is not true the taxpayer is in a position to explain the discrepancy. The application of such an assumption raises serious legal problems in the administration of the criminal law.

Unlike civil actions for the recovery of deficiencies, where the determinations of the Commissioner have prima facie validity, the prosecution must always prove the criminal charge beyond a reasonable doubt. This has led many of our courts to be disturbed by the use of the net worth method, particularly in its scope and the latitude which it allows prosecutors. (Citations)." (Emphasis added.)

The Court, on pages 127 and 128, then analyzes the dangers encountered in using circumstantial evidence:

"This leads us to point out the dangers that must be consciously kept in mind in order to assure adequate appraisal of the specific facts in individual cases."

The Court then lists six (6) such dangers. In Item No. 4, the Court states:

"When there are no books and records, willfulness may be inferred by the jury from that fact, coupled with proof of an understatement of income. But when the Government uses the net worth method, and the books and records of the taxpayer appear correct on their face, an inference of willfulness from net worth increases alone might be unjustified, especially where the circumstances surrounding the deficiency are as consistent with innocent mistake as with willful violation. On the other hand, the very failure of the books to disclose a proved deficiency might indicate deliberate falsification."

The Court then considered the facts at hand (pp. 131-132):

"Petitioners' accounting system was appropriate for their business purposes; and, admittedly, the

Government did not detect any specific false entries therein. Nevertheless, if we believe the Government's evidence, as the jury did, *we must conclude that the defendants' books were more consistent than truthful, and that many items of income had disappeared before they had even reached the recording stage.* . . . To protect the revenue from those who do not render true accounts the government must be free to use all legal evidence available to it in *determining whether the story told by the taxpayer's books actually reflects his financial history.*" (Emphasis added.)

The *Holland* case was both restrictive and liberal in setting standards to be followed in determining taxable income through the introduction of circumstantial evidence. The Court clearly states that the Internal Revenue Service may use circumstantial evidence in cases other than where the taxpayer has no books, or where his books are inadequate (p. 131). What the Court in reality said is that the net worth method may be used to establish the fact that the taxpayer's books are inaccurate; consistency on its face cannot be equated with accuracy. However, the Court was restrictive in that it set limitations on the use of the net worth method, and throughout the opinion stated that the use of circumstantial evidence in a tax case creates many dangers for the taxpayer.

Circumstantial evidence is normally received but viewed with distrust. In a tax evasion case under 26 U.S.C. 7201, the Court in *Cohen v. United States* (5th Cir., 1966), 363 F. 2d 321, 327, stated:

"The circumstances proven must lead to the conclusion with reasonable certainty and must be of

> such probative force as to create basis for legal inference and not mere suspicion, *Wesson v. United States*, 8th Cir., 1949, 172 F. 2d 931. In the absence of direct proof, the circumstances relied upon to sustain a conviction must not only be consistent with guilt, but inconsistent with every reasonable hypothesis of innocence. *Barnes v. United States,* 5th Cir., 1965, 341 F. 2d 189."

This Court set aside a perjury conviction in *Whaley v. United States* (9th Cir., 1966), 362 F. 2d 938, 939, and stated:

> "While circumstantial evidence may support a conviction, it must be adequately sufficient to enable a reasonable determination that it excludes every hypothesis except that of guilt."

(ii) Riganto Case.

In the case of *United States v. Riganto* (D.C. Va., 1954), 121 F. Supp. 158, the Court carefully considered the applicability of the bank deposit method in establishing an understatement of income. The Court noted, at page 159:

> "In the last few years I have observed with interest a change that has taken place in the nature of proof offered to support the charge of the prosecution in many of these cases charging tax fraud. This change has caused me some concern by what appears to be a *preference to introduce proof to show understatement of income and fraudulent attempt by methods other than by direct evidence.* Of course, it is necessary in some cases that the Government procede by indirect methods. This evidence consists of proof undertaking to show in-

come of the taxpayer computed upon what is referred to as the net worth increase or bank deposits and expenditures methods, or a combination of both. The latter is employed here. Basing my observation upon a number of cases during the past few years, *it would seem that the use of one or both of these methods has been employed through preference at times when direct evidence is available.*" (Emphasis added).

At page 161, the Court holds:

"As I stated a while ago, the Commissioner has discretion to use a method other than the bookkeeping method regularly employed by the taxpayer only when the method employed by the taxpayer does not clearly reflect the true income. I have heretofore ruled, and I adhere to that ruling, that the burden is upon the Government to show, before resorting to another method, the inadequacy of the books and records employed by the taxpayer. The Government must also show that the net worth method, the bank deposits method, or whatever other method is adopted, does reasonably reflect the income of the taxpayer. In meeting that burden, the Government must introduce evidence, other than its own computation, *to discredit the books and records of the taxpayer, such as proof of unrecorded transactions, or internal evidence within the books themselves showing incompleteness or inaccuracy.*" (Emphasis added.)

Appellant contends that the *Riganto* case, *supra* is sound in its rationale. It is true that the Supreme Court diluted the holding of Riganto somewhat in *Hol-*

land v. United States, supra, at page 131. However, *Holland* did not reject the contention that, where there was no evidence of the insufficiency or inaccuracy of the books and records, as here, the use of the net worth method would be improper. The *Holland* case stated that the Government may go outside the books themselves to *discredit the books.*

All of the case law cited herein, and that anticipated in the Government's reply to this brief, are consistent with the theory propounded by appellant. The net worth method may be resorted to by the Government in order to establish the *inaccuracy* of the taxpayer's books and records. The fact that the books and records are consistent with the tax return does not, in and of itself, deprive the Government of the use of the net worth method. The courts recite the above statement of law in virtually all cases where the *books and tax return are consistent but incorrect.* The courts dwell upon the veracity of the books and records, not the tax return. Thus, even in the *Holland* case, the Court holds that the net worth method may be used *to demonstrate that the books and records are inaccurate,* and *then* holds that the net worth method may be used to compute the defendant's taxable income.

In this case we have the near-incredible fact situation in which the books and records have not been challenged, and in all probability are correct. The issue before the Court is whether the adequacy and accuracy of the taxpayer's books and records may be acknowledged by the investigating agent, thereby permitting him to directly ascertain tax liability through the use of circumstantial evidence, *i.e.* the net worth or the bank deposit method. Appellant urges the Court to reject

that test, and hold that the Government must prove the inaccuracy of taxpayer's books and records before it may prove its substantive case through introduction of circumstantial evidence.

(iii) **Dual Purpose of Bank Deposits Method.**

In the case of *Schwarzkopf v. Commissioner of Internal Revenue* (1957), 246 F. 2d 731, 733-734, the Court of Appeals for the Third Circuit correctly interpreted the *Holland* case, *supra,* and established a two-fold use of circumstantial evidence:

> "This quoted portion of the *Holland* case is recognized by petitioner as sanctioning the use of the net worth method to test the accuracy and completeness of the books of account. *Thus, the net worth method serves two purposes: First, it may be used to test the correctness of the books; secondly, it is cogent evidence of the amount of income which went unreported.* The fact that the books on the face appear to be adequate does not preclude the use of the net worth method. *Holland v. United States*, supra, 348 U.S. at pages 131-132, 75 S. Ct. at page 133. In any event, the books involved here contained items of net income with hospital expenses already deducted. The disposal by the taxpayer of bills evidencing these expenses made the computation of their amount impossible, and thus left vague and unreported some unknown amounts of income. The taxpayer's practice of cashing checks representing his patients' fees and receiving the money in large denominations rather than depositing the checks themselves made it impossible to test the accuracy of the books from that source. If taxpayer's contention is correct, every-

> one could keep a set of apparently accurate books, carefully destroy other evidences of the source and amount of income, and defend by an alien rule that the net worth method may not be used in those circumstances—and thus the government could be defrauded with impunity. *However, it is when other methods of disclosing income fail, that the net worth computation becomes especially important in the collection of revenue.*" (Emphasis added.)

The above quoted rule regarding the dual purpose of the net worth method, *i.e.,* to test the taxpayer's books and records, and secondly, to serve as evidence of unreported income, was approved in *Hoffman v. Commissioner of Internal Revenue* (3rd Cir. 1962), 298 F. 2d 784, 786. Appellant believes the above stated rule directly reflects the viewpoint of the Supreme Court as expressed in the *Holland* case, *supra.* It is consistent with the warnings found throughout *Holland.* The philosophy expressed is that an apparently accurate and consistent set of books and records shall not frustrate the Government's attempt to show that income has been understated. The Government may use the net worth method, or any other method constituting circumstantial evidence, first to disprove the *accuracy* of the taxpayer's books and records. Once the books are demonstrated to be inaccurate, said method of circumstantial evidence may be used to *approximate* the taxpayer's taxable income.

The above stated rule has been expounded upon on numerous occasions by the Tax Court. In *Ruth N. Bishop* (1962), T.C. Memo 62-146, the Court stated:

> "The right of respondent to resort to the net worth method is not dependent upon finding first (and

without regard to the implications of the net worth computation) that petitioners' books and records were not sufficient to properly reflect income. It is quite possible that even though a taxpayer may have a complete set of books and may employ a method of accounting which is capable of accurately reflecting the taxpayer's income, there may be false or incorrect entries made on his books, such as nonbusiness expenses, omission of cash receipts, and the like. In *Estate of W. D. Bartlett,* 22 T.C. 1228 (1954), we held that where the taxpayer presents a set of books and records which appear to be superficially adequate, the so-called net worth method may be resorted to and applied as a technique for disclosing a substantial gap between actual income and reported income, *and thereby suggest untrustworthiness of the books as a whole.* See also *Morris Lipsitz,* 21 T.C. 917 (1954), affd. 220 F. 2d 871 (C.A. 4, 1955), certiorari denied 350 U.S. 845 (1955)." (Emphasis added.)

In *Estate of Joe Wright* (1963), T.C. Memo 63-088, the Court stated:

"In any event, it is well established that the net worth method may be used even though a taxpayer maintains a set of books; *that such method may be used to test the accuracy of the books and the returns; and that when properly employed, such method may show that the books are not trustworthy. (Citations).*" (Emphasis added.)

A similar statement is found in *Julius Godeny* (1963), T.C. Memo 63-324:

"Petitioner contends that he kept adequate books and records for the years here involved and that

> the respondent was not justified in computing unreported income for this period by using the net worth method. Petitioner's contention is without merit. Where a net worth computation shows increases in net worth greater than that reported on a taxpayer's return, or is not consistent with his records, then the net worth computation is evidence that there is unreported income and *that the records, though seemingly complete on the face, are adequate, inaccurate or false.*" (Emphasis added.)

(iv) "Most Accurate Method" Test.

Appellant contends that, considering the dangers encountered in prosecuting taxpayers based upon circumstantial evidence, the investigating agent should be required to use that method for determining income which will most accurately reflect, or, if necessary, reconstruct the taxpayer's income. Appellant will demonstrate below that *all* income was reflected in his books and records, and that the Government agents, for reasons unknown to appellant, chose to reconstruct his taxable income by the use of the bank deposits method. It will also be shown below that the use of this method has not avoided all possibility of double inclusion of bank deposits, and eliminated transfers between banks. Under the circumstances of this case, it is clear that the most accurate method for determining appellant's taxable income for the years in question is through the use of the books and records maintained by appellant contemporaneous with his business transactions.

In the case of *Grace O. Dean* (1955), T.C. Memo 55-217, the Court disapproved of the use of the bank deposits methods, and noted:

> "It is true that petitioner's records were not maintained in an approved manner. They were apparently incomplete and in the circumstances the respondent in his determination was justified in adopting some method which would as nearly as possible correctly reveal petitioner's taxable income, if any. *The absence of complete recorded entries, however, does not justify his ignoring the obvious or excuse a failure to weigh and consider objectively the information and data which is supplied or otherwise available to him.*" (Emphasis added.)

In the case of *W. L. Harris* (1948), T. C. Memo 48-235, the Court concluded that the use of a variation of the bank deposits method was improper:

> "We deem it unnecessary to discuss at length each year from 1919 to 1937, inclusive. During that period (in 1925) the petitioner's records were burned. He had records of the monthly income from his practice thereafter and from October 17, 1928, *he has maintained card records of his patients. He stated, 'I have a record of every patient I wait on, what I did and how much I collected.' The agent was informed of the card system and the petitioner offered to show him any records at any time. The agent arbitrarily termed these records 'inadequate' and declined to employ them.*" (Emphasis added).

In *Blackwell v. United States* (8th Cir. 1957), 244 F. 2d 423, 427, 428, the Court stated:

> "In our present case, as previously stated, the defendant preserved only monthly totals of his cash sales. The memoranda upon which the monthly totals were based were not available for checking. The investigation also disclosed that the total deposits exceeded the total receipts. It is true, as defendant contends, that if his books were accurate and complete they would reflect his entire income. There is substantial evidence of an increase in defendant's net worth during each of the years involved in an amount considerably in excess of his reported net income. Defendant's explanation of this increase is the hoarded cash which he placed in the business. If the Government has proven that defendant did not have this hoarded cash, then the only source for the increased net worth above the reported income would be the defendant's furniture business. The Court, several times in its instructions, advised the jury in effect that, *if defendant's records reflected substantially all transactions of importance on the question of income, such records are the best evidence, and in that event the Government could not establish income by the net worth method. The evidence presented a fact question for the jury on the adequacy and truthfulness of defendant's records.*" (Emphasis added.)

Also worthy of note is the Court's statement in *Merrit v. Commissioner of Internal Revenue* (5th Cir. 1962), 301 F. 2d 484, 486:

> "The petitioner asserts that this case is not one calling for the application of the net worth method of determining income because adequate records were kept. *If the records of the taxpayer are inaccurate or incomplete the Commissioner may look to other information to determine whether the tax payable has been correctly returned by a taxpayer.* (Citations). Although the petitioner engaged the services of a bookkeeper in 1945, the entries in the books were only of such items as were reported by the petitioner to the bookkeeper. It was clearly established that much vital information was withheld by the petitioner from the bookkeeper. The net worth method was properly invoked." (Emphasis added.)

In their extensive research, counsel for appellant have been able to find but one case in which the taxpayer's books and records were inconsistent with his income tax return. In *Moore v. United States* (5th Cir. 1958), 254 F. 2d 213, the taxpayer claimed that his books and records were in fact inaccurate, and that the net taxable income as shown on his income tax return was in fact correct. The Government attempted to prove its case by basing its understatement of income on the discrepancy between the books and the tax return, claiming that the books reflected taxpayer's true income. They prepared a net worth statement as corroboration and as rebuttal to the defendant's argument that his books did not correctly reflect his taxable income. Fraudulent intent was demonstrated through the testi-

mony of taxpayer's accountant, who related how taxpayer arbitrarily instructed him to adjust the income from his books in preparing his tax return, and his direct admission to the accountant acknowledging that he was falsifying his return. Contrast that method of proof to the manner in which the Government presented the case now before this Court.

B. Evidence as to Defendant's Books and Records.

The evidence outlined below will show the following facts: The defendant's records were maintained by his secretaries and by his nephew, Henry Oppenheim. The secretaries maintained books in which they listed the total amount of the recovery awarded for each client. This record was maintained for the purpose of assuring that each award was sent to the defendant, and in effect constituted an accounts receivable journal. Each girl also maintained a cash receipts book wherein she listed the amount of money received, and the amount still owed on account. Individual account cards were kept for each client. They stated the amount to be received, noted the subsequent costs incurred, and monies collected. The testimony indicates that none of these records were ever destroyed, that they were kept in the ordinary course of business, served as the financial records for the business, and that none of these records were ever requested by the investigating agents.

The testimony describing the defendant's books and records came from three employees. Magdelena Lewin was employed by the defendant during the entire period covered by the indictment [Tr. p. 64], as was Margot Baerlein [Tr. p. 180] and Henry Oppenheim [Tr. p. 464]. Mrs. Lewin testified as to the general business

procedure for handling the awards from Germany. In many cases there was a corresponding attorney in Germany. The defendant would write a letter to the German attorney, authorizing him to deduct his percent of the fee, and also directing him to place a 6% fee in a German bank for Mr. Roy. The net amount would then be transferred to the United States [Tr. p. 81.] The tenor of the transcript indicates that it is the fund retained in German banks for Dr. Roy which created the evidence relied upon by the Court in determining fraudulent intent. There were also payments of fees made directly to Dr. Roy in cases where there was no corresponding German attorney, or where the awards were paid directly to the client. The transcript indicates that these amounts were either reported on the appellant's tax return, or were disclosed to the revenue agent at the inception of his initial meeting with the taxpayer. The following is an analysis of how these transactions were reflected in the appellant's books and records.

1. *Book Detailing Awards.* Appellant's secretaries maintained books which in fact constituted an accounts receivable journal. This book is described by Mrs. Lewin on page 92 of the transcript. She states that a letter would come from the compensation office notifying Mr. Roy of the award. Mrs. Lewin states:

> "and then I wrote it down in a book for each individual client, he would receive so-and-so much, *and that some fee for Mr. Roy was already deducted. I put this also in this book.*"

In Transcript pages 93-95 Mrs. Lewin is questioned as to letters from the corresponding attorneys wherein said attorneys stated that they had deducted 12% of the award, 6% for themselves and 6% for Mr. Roy, and

were in the process of forwarding the net award. At Transcript page 95, Mrs. Lewin was asked if she came in contact with those letters to make further records from them, and she responded:

> "Yes, I received the statement when somebody received an amount because I had to put this in a particular book."

In further describing the book [Tr. pp. 96, 97], Mrs. Lewin stated that when the statement arrived as to what a particular client would receive, she would enter the name of the client, and the amount of the award. She also states [Tr. p. 97]:

> "And the amount, and when the fees were deducted in Germany, I would write down so-and-so much fees were deducted by the lawyer in Germany, and that he—and that from this amount Mr. Roy received so-and-so- much."

When the bank deposit slips arrived from the German bank, the amount of the deposit would be checked against the amount listed in the record of fees retained in Germany. [Tr. pp. 98-99.]

Mrs. Lewin further described the award book on cross-examination. Said book was identified as defendant's Exhibit "B" for identification purposes and presented to Mrs. Lewin. She stated that the book was mostly in her handwriting and that:

> "This book means that when a client receives funds from Germany—I mean when Mr. Roy received notice that the client will receive funds, then I enter the name of—the date of the letter and the name of the client, and the amount which the client will receive." [Tr. pp. 163, 164.]

On page 166, in response to the question, "Well, may I suggest that one of the purposes of Exhibit 'B' was to keep a control over awards awarded but not yet paid?", the witness's response was, "That is true." The award book was a log or an inventory of what was outstanding but not yet received.

2. *Cash Receipts Book.* At pages 161-163 of the Transcript, Mrs. Lewin described the cash receipts book:

> "Each girl had her book in which they entered the fees which were received on the particular day."

Defendant's Exhibit "A" for identification was one such book. The cash receipts were then transcribed to individual client's accounts.

Mr. Oppenheim further amplified the use of the cash receipts book:

> "Well, my duties were to see each girl kept their own record book, you know, the books that they transact during the day, in the work that they have done. And it was my duty to transpose those items in these cards that we have here." [Tr. p. 465.]

He then identified defendant's Exhibit "A" for identification as the girl's book that he had referred to.

3. *Account Client Cards.* Mrs. Lewin indicates that each individual client had a client file, and an open account card. As checks came into the office there was an attachment stating which client the check pertained to. A girl in the office would pull the account card and file for that client, and take them to Mrs. Lewin. Mrs. Lewin then took the account card into Mr. Roy. The

file indicated what the agreed fee was and the account card listed the receipt of the award and the expenses pertaining to the client. Mr. Roy then indicated what sum should be mailed to the client. [Tr. pp. 102, 103.] The checks received from Germany would be deposited in a trustee account at Security Bank or Bank of America. [Tr. p. 104.] Mrs. Lewin later states on cross-examination, that the cash receipts figures from the cash receipts book were transcribed to each client's open account. [Tr. pp. 161, 162.] She identified defendant's Exhibit "C" for identification as such an account card. As each check was received, it was entered on the account card. [Tr. p. 165.] The account cards were kept in Mr. Roy's offices, and accessible to everyone in the office. [Tr. p. 167.]

Mrs. Baerlein testified that the account cards were maintained for each and every client, that she could not recall any instances in which a card was not made out for a client, or of any instances where cards were destroyed. [Tr. pp. 202-204.]

Mr. Oppenheim testified that he would transcribe the information from the cash receipts books to the account cards:

> "Manually I would put down the date that the person really was in the office, the customer, and I'd put down the amount that was written, you know, the amount, the letter, and so forth, the amount and the new balance. That is all the transactions I did." [Tr. p. 466.]

Mr. Oppenheim also testified that to his knowledge, no account cards were ever destroyed or missing. [Tr. p. 467.]

C. Agent's Investigation of Available Books and Records.

It is clear from the Bill of Particulars, plaintiff's Exhibit 69, and the general tenor of the transcript that the Government has used the bank deposit method for reconstructing income. Special Agent James P. Donley testified to that effect. [Tr. pp. 343, 344.] Appellant has described above the books and records which contain all of his gross receipts, both those reported on the tax return, and those which were omitted. What use did the investigating agents make of those records, and to what extent did they use them to establish unreported income?

In reviewing the testimony of Agent Donley, it is clearly demonstrated that the *only records* that were ever requested by the Government were those from which the agents would be able to reconstruct the figures shown on the income tax return. [See for example Tr. p. 279.] Counsel has been unable to find one statement in the entire transcript in which the investigating agents state that they asked for all records which would show the total amount of awards, receipt of all fees, both within the United States and abroad, or any other record from which to compute the defendant's *actual income*. The intent of the audit as expressed to the defendant by Agent Donley was a desire to reconstruct the income as shown on the tax return, rather than attempting to ascertain the total amount of awards received by the defendant's clients, and the fees received from those awards. It is apparent that the investigating agents were aware of the fact that there was technically unreported income (this fact was made known to Agent Breese at the in-

ception of his initial interview with the defendant [Tr. pp. 210, 211]), and were attempting to reconstruct which specific items of receipts were unreported so as to ascertain fraudulent intent. [Tr. p. 276.] The agents never asked for the records which would disclose taxpayer's true income, and never attempted to determine the existence of same.

Revenue Agent Charles Breese stated that he was given a tour of Mr. Roy's office, and that he viewed numerous files and file cabinets. [Tr. p. 214.] At the same time, he was given the cash receipts book and made a few preliminary notes of some of the figures contained therein. Mr. Breese stated that he saw the filing cabinets, but did not ask to review their contents or inquire into same at any time. He also stated that he was familiar with the client's account cards. [Tr. p. 218.] Consider the following testimony from Transcript pages 227-230:

> "Q. Mr. Breese, you said you were familiar with Defendant's Exhibit "C" for identification, which is that client's card. A. Yes, I have seen that before.
>
> Q. Did you ask for the client's cards? A. Never.
>
> Q. Were you ever refused the client's cards? A. Never. I never asked.
>
> * * * *
>
> Q. First of all, if you were present when Mrs. Lewin and Mrs. Baerlein were previously interviewed by the Internal Revenue Service. You indicated yes? A. I was.
>
> Q. At that time, during the course of the interviews, were you aware of the existence of the

cards reflected and similar to Defendant's Exhibit C for identification? A. Yes, they had told us of such cards—

Q. And did they discuss with you and Mr. Donley, or with Mr. Phoebus—either one—the use of those cards and what entries were made on them? A. Yes, they told us that.

Q. Are you mindful of the fact, Mr. Breese, that the clients' cards, much like a patient's card, dentist's card or doctor's card, contained the financial history or the relationship—financial relationship between Dr. Roy and the individual client? A. Well, I don't know what his relationship was, but I do know what the cards contained from only what the girls had told us.

Q. But you did not ask for those cards? A. I did not.

Q. So you do not know, or is it correct to state, Mr. Breese, that you do not know whether or not Mr. Roy's records are or are not adequate? A. I do not know."

(The preceding question is amplified so that the question indicates whether the books and records were adequate for the determination of income).

"Q. Is that correct, Mr. Breese? A. Well, the records that he had furnished to us were not adequate.

Q. Did you ask him for these cards? A. Not for these cards.

Q. You knew the meaning of these cards after being a participant at the interview of the witnesses? A. Yes.

Q. Mrs. Baerlein and Mrs. Lewin? A. Yes."

Mr. Donley also testified that he had never asked for the client account cards of the defendant. Mrs. Lewin and Mrs. Baerlein had informed him of the fact that they kept open accounts on each client. [Tr. p. 350.]

The testimony produced at trial, and enumerated above, clearly indicates that the defendant had books and records from which his true taxable income could have been ascertained. The investigating agents never sought to make use of the available records. They attempted to prove through the use of circumstantial evidence that income had been omitted and that such income had been omitted with fraudulent intent. It is true that the record does not disclose the defendant's attempt to *force* the records which would truly reflect his income upon the investigating agents, and their subsequent refusal to accept such records. Is any taxpayer so obligated? At the inception of the audit the defendant disclosed income omitted from his tax return. After undergoing a brief period of interrogation, he was next confronted by two agents who immediately stated that they were investigating "fraudulent intent" and then asked for records detailing his bank deposits. He produced those records in a sporadic manner. Mr. Roy then attempted to trace the deposits by indicating the source and character of each deposit. It appears that the investigating agents had predetermined their method of investigation, and immediately set about to develop a bank deposit case. It is neither logical nor sound as a matter of policy to require the defendant in a potential criminal case not only to comply with the requests of the investigating agents, but also to force upon them the records which he feels may be more pertinent.

D. Dangers of Bank Deposits Method.

The most obvious dangers arising through the use of the bank deposits method as circumstantial evidence to prove omitted income are the possibilities that inter-bank transfers will be ignored, and that bank deposits which are not items of taxable income will be so included. Consider the thoroughness of the investigation in this case. [Agent Donley, Tr. p. 344]:

> "Q. Could you tell us with respect to the, to your investigative work, and with respect particularly to your own knowledge, whether deposits made in any bank bearing Dr. Roy's name, other than in Los Angeles, was not in fact picked up in deposits in Los Angeles bank accounts?
>
> The Court: Do you understand the question?
>
> The Witness: Yes, sir, I do, I personally could not as—as to the composition of funds going in this account I do know where they came from. I can trace them. But going beyond this account I don't know."
>
> Mr. Hochman:
>
> "Q. So you don't know one way or the other? A. That is correct."

The testimony of Agent Breese also reflects upon the thoroughness of the investigation [Tr. p. 226]:

> "Q. Can you tell us as to whether, in terms of your knowledge and your audit, do you know or do you not know whether or not the money that other witnesses and exhibits have talked about with respect to the Berliner Disconto account, are or are not reflected in deposits to accounts here in the name of Henry Roy, in personal capacity or in his trustee capacity? A. I can't state that.
>
> Q. In other words, you can't state it either way ? A. I cannot, that is correct."

The above testimony is particularly enlightening in view of the fact that the defendant apparently made statements to the investigating agents which they, and the Court, considered to be untrue with respect to the Berlin bank accounts. However, the Government has not proved that the Berlin bank accounts represent fees which were not subsequently deposited in bank accounts in the city of Los Angeles, and thereafter reflected in the cash receipts, or disclosed to Agent Breese as omitted income at the inception of the audit.

The transcript discloses that the defendant spent months tracing deposits [Tr. pp. 302-303], attempting to ascertain their source and character at the agents request. The correct figures of income were available within his books and business records and the above work was not only inaccurate, but unnecessary. The Court can well note the strain accompanying an Internal Revenue investigation, particularly when the taxpayer has acknowledged and previously disclosed gross receipts which are not reflected on his tax return. If the investigation had proceeded properly, the agents would have asked for all books and records which reflect items of receipt, whether considered taxable or tax-free by defendant, *rather than request records from which to reconstruct those figures actually reported on the tax return.* If the agents had requested and received those records, there would have been undisputed records disclosing the fees received. The bank deposits are in fact irrelevant for the purpose of ascertaining income in this case, and the taxpayer would have been relieved from the onerous task of disclosing bank accounts and analyzing the receipts therein during a three year audit. The taxpayer at all times contended that

only a portion of the bank account deposits constituted taxable income, and a proper investigation would have concerned itself with fees received, rather than with taxable vs. non-taxable bank deposits. It is suggested that the information requested by the agents and hesitantly supplied by the defendant was irrelevant, and that misstatements of fact or opinion would not have been forthcoming were the taxpayer not required to undergo the stress of supplying unnecessary information.

II.

WILLFULNESS.

The appellant contends that there is insufficient evidence to sustain a finding of willfulness within the meaning of Section 7201 of the Internal Revenue Code of 1954, 26 U.S.C. 7201. A finding of willfulness is one of the required elements of the crime charged in the indictment. In the context of the statute, that term means bad purpose, evil motive and an act done with the specific intent to accomplish that which the law forbids. *United States v. Murdock* (1933), 290 U.S. 389, 394, 395, 54 S. Ct. 223.

Appellants' contention is based on the fact that the record of this case discloses a complete lack of evidence of willfulness such as was indicated in the case of *Spies v. United States* (1943), 317 U.S. 492, 499, 63 S. Ct. 364, 368. In the *Spies* case, *supra,* the Supreme Court of the United States, in effect, stated that it considered evidence of willfulness to be:

> ". . . conduct such as keeping a double set of books, making false entries or alterations, or false invoices or documents, destruction of books or records, concealment of assets or covering up sources

> of income, handling of one's affairs to avoid making the records usual in transactions of the kind, and any conduct, the likely effect of which would be to mislead or to conceal. . . ."

Although the above examples were ". . . By way of illustration and not by way of limitation . . .," there is not present in this case any such conduct. There was only (1) set of books present in this case, a set which the Internal Revenue Agents chose to ignore. There were no false entries on the said records or alterations thereof. There were not "false invoices or documents" nor was there any "destruction of books or records." Indeed the taxpayer presented all his records dating back to year one—in this case 1949. [Tr. p. 467.]

The appellee has attempted to argue in the Court below that the appellant had "concealed his assets or covered up sources of his income", *i.e.* the so-called "Berlin bank accounts", claiming that these accounts were not disclosed to the Internal Revenue Service. This argument is irrelevant in the present case by reason of the fact that the Internal Revenue Service was computing taxable income by means of the bank deposits method of computing taxable income. [Tr. pp. 343, 344.] This being the case, it was incumbent upon the appellee to prove that the funds in these Berlin bank accounts were not also included in the American bank accounts, and thereby not reported as income. This the appellee could not do and such fact was admitted by Special Agent James Donley on cross-examination. [Tr. p. 344.]

It is difficult to see how the failure to supply the detailed records on the Berlin bank accounts can be

viewed as indicating intent to defraud, when considering the Government's position that the Berlin bank accounts were not reported on the tax return, and the expressed purpose of the audit was to "reconstruct the tax returns."

Note that in the testimony of Mr. Breese, there is no statement as to a request for *any* records. He does state that near the conclusion of his first interview Mr. Roy made available to him his cash receipts book, and Mr. Breese took a few notes from that book reflecting items of unreported income. [Tr. pp. 214, 215.] Special Agent Donley requested the records in the following manner [Tr. p. 279]:

> "I had explained to Dr. Roy that what we would like to do would be to *reconstruct his income as filed on the returns,* and in connection with that he gave me his—it was a summary of cash receipts which—not cash receipts exactly, it was a summary of receipts that had been deposited into his personal business account. He also gave me—this is for '56 through '60. He also gave me copies of the cash disbursements records, or check registers of '56 through '60.

On cross examination he describes his request as follows [Tr. p. 352]:

> "When I first interviewed Dr. Roy I told him that I would need records, *the same records that he used to prepare his returns.* And at that time that is when he gave me his cash deposits book, the total of which agreed with the amounts reported on the '56 return."

Agent Donley also stated that Dr. Roy had said, "That from the records that we had that we could re-

construct the returns just exactly like the one he had given us." [Tr. p. 281.] This statement is true in all respects. It follows the agent's request for books and records from which to reconstruct the income tax return. The three investigating agents failed to state during the trial that they had ever requested records reflecting all receipts from fees, or all receipts of any nature, or all items of taxable and non-taxable income, or any similar request.

The investigating agents were put on notice as to the nature of Mr. Roy's income at the beginning of the audit. At Transcript pages 210, 211, Revenue Agent Breese states that Mr. Roy told him that he had unreported income at the inception of his initial interview. He also stated that he had previously reported items similar in nature to that omitted on the tax returns under audit. Mr. Roy said that he collected as his fee a percent of the awards, *i.e.*, indicated that there was a contingent fee arrangement. Mrs. Lewin describes how Mr. Roy claimed only a percentage of his expenses on his Federal income tax return. [Tr. pp. 130-134.] Agent Phoebus stated that Dr. Roy told him that *German attorneys* retained a portion of the fee. [Tr. p. 259.] The above statements, along with taxpayer's books and records, clearly advised the investigating agents at the beginning of the investigation as to the sources and nature of all of Mr. Roy's income.

There are indications in the transcript that the defendant made false statements concerning the Berlin bank accounts. These statements were made approximately two and one-half years after the investigation began. It is significant to note the circumstances leading up to these false statements.

During Mr. Donley's first visit with Mr. Roy, he testified that:

> "I explained to Dr. Roy that I was taking Special Agent Phoebus' place in the investigation, that I was primarily *concerned with whether or not there was a criminal intent with regard to the unreported income* that he told Mr. Breese about." [Tr. p. 276.]

Prior to that meeting Mr. Roy had described the nature of his business and disclosed that he had substantial unreported income. The investigating agents then proceeded to put Mr. Roy to work in reconciling the bank deposits to his trustee and personal accounts, requiring that he indicate the character of each deposit, and admit the taxability thereof. [Tr. pp. 221-225.] This reconciliation was subsequently used during the trial for establishing an understatement of income and to establish willfulness. However, the reconciliation was for the purpose of reconciling the defendant's tax return, rather than ascertaining his tax liability. It is apparent that the longer the investigation proceeded, the more futile and ineffectual were the agent's efforts, and the more discouraged and scared became Mr. Roy.

It is also significant to note that the defendant clearly and honestly believed that the funds received from the awards were held initially in a trust capacity [Tr. pp. 81, 104], that refunds were made to clients from these accounts [Tr. p. 125], and that the bank accounts in Germany were attached pursuant to German court proceedings on September 3, 1963. [Tr. pp. 405-411.]

The Government cannot prove the essential element of willfulness by the introduction of evidence leading to speculation of fraudulent intent, but must prove this element of the crime beyond a reasonable doubt. Appellant submits that the Government has not met its burden of proof.

III.
CONCLUSION.

This case has great importance! It affords this Honorable Court the opportunity to delineate the guidelines for tax investigations of a criminal nature when they deal with "adequate" and "accurate" books and records.

The *Holland* decision permits the Government to proceed on alternate methods of computing taxable income, *i.e.*, net worth and bank deposits, because though books and records exist, ". . . many items of income had disappeared before they had even reached the recording stage . . ." and, because the books were ". . . more consistent than truthful."

This is appropriate in its own context. However, where the books and records are adequate and accurate we suggest that alternate methods are not employable. In the case at bar the defendant, rightly or wrongly, made an allocation between non-taxable and taxable receipts. Other than in 1960, this was not done on the face of the return. However, expenses were similarly allocated, *i.e.*, between deductible and non-deductible—following the same ratio of taxable and non-taxable receipts, and this was revealed within the four corners

of the income tax returns. More important, the defendant voluntarily revealed his treatment and allocation to the revenue agent at the very outset of the audit and investigation.

In this frame of reference, should the Government be permitted to ignore the books and records and conduct a lengthy and unusual (to a taxpayer with adequate and accurate records) audit and investigation, and further be permitted to use alternate methods fraught with their own dangers?

From the viewpoint of the taxpayer it borders on the incredible for the Government to pursue an investigation that virtually ignores the fountainhead and source of information, namely, the underlying records. This indirect method must breed distrust and creates a charged atmosphere in which cooperation will collapse. Had this audit been properly handled the taxpayer-defendant could not have made damaging admissions which admissions were generated in a hostile environment.

The taxpayer paid salaries to many employees for the principal purpose of having records and data for his own clients, but for the secondary purpose of having a set of books to be audited. To this day no such audit has been conducted by the Government. Unless and until the agents or other professional witnesses of the Government can testify that the records are inadequate and inaccurate, the bank deposit method should not be allowable. The *Holland* case approves of the bootstrap approach, to wit: allowing the use of a circum-

stantial method to prove its need. However, inherent in that opinion is the underlying assumption that the taxpayer's books and records were unavailable (Fifth Amendment umbrage) or were not truthful. In this regard it was assumed by the Holland Court that the agents audited what records were available. Nothing detracts from the obligation of the agents to audit records maintained in the normal course of business. There is no bootstrap operation in this case; there is rather a unilateral determination to use the bank deposit method notwithstanding the veracity and integrity of the books and records. In order to avoid paying more than lip service to the fears of the use of circumstantial evidence in a criminal tax case, this Court should clearly reaffirm the proposition that the Government must audit what is available before proceeding to alternate theories.

The use of circumstantial evidence should be a secondary approach rather than a primary audit technique. Picture, if you will, the posture of the present case were this done:

1. The evidence would show the books were accurate and adequate.
2. There would be a difference between taxable gross receipts and gross receipts per return.
3. This difference was explained by the taxpayer in terms of an erroneously believed legal interpretation.
4. The treatment of deductions followed the taxpayer's treatment of income.

In this context the discussions with the taxpayer are minimal, if any, and the Government would be hard pressed to even establish civil fraud. *The whole area of intent would remain limited to belief at the time the return was filed, rather than being extrapolated from post-return discussions unnecessarily generated by the indirect approach.*

The bank deposit method is no substitute for primary auditing. Taxpayers should be protected from lengthy harassment, however inadvertent, necessitated every time indirect methods are employed.

Respectfully submitted,

HOCHMAN & SALKIN,
Attorneys for Appellant.

Certificate.

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those Rules.

Bruce I. Hochman,

APPENDIX.

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75	49	308	308
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82	358		
83	366	366	367
84	417		
85	462	462	462
A	161		
B	161		
C	161		
D, E and F	402		
G	413		

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vs.

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Appellee.

APPELLEE'S BRIEF

APPEAL FROM
THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF CALIFORNIA
CENTRAL DIVISION

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APPELLEE'S BRIEF

I

JURISDICTIONAL STATEMENT

The appellant, Henry Roy, was indicted by the Federal Grand Jury for the Central Division of the Southern District of California on April 7, 1965. The indictment was brought under 26 U.S.C., Section 7201, and charged that the appellant willfully attempted to evade and defeat a substantial part of his Federal income tax liability for the calendar years 1958, 1959, and 1960. The indictment charged that appellant understated his taxable income by $81,887.60, $113,861.07, and $158,535.21 for the respective years. The indictment charged that appellant's understatement of his taxable income resulted in an additional Federal

income tax liability for the three years in the amount of $52,206.39, $77,182.73 and $115,497.70.

On April 26, 1965 appellant pleaded not guilty to all three counts. The case proceeded to trial before the Honorable Charles H. Carr on March 15, 1966, and was concluded on March 17, 1966. The Court found appellant guilty of all three counts of the indictment [C.T. 27]. 1/

The appellant timely moved for a new trial, or in the alternative for a judgment of acquittal [C.T. 8]. Both motions were denied by the Court. On May 2, 1966, the appellant was sentenced to serve a period of six months in custody and to pay a fine of $30,000.00 [R.T. 652]. 2/

Appellant's Notice of Appeal was timely filed [C.T. 27-28].

The jurisdiction of the District Court was based upon Title 26, United States Code, Section 7201, Title 18, United States Code, Section 3231 and Rule 18 of the Federal Rules of Criminal Procedure. This Court has jurisdiction to review the judgment of the District Court pursuant to Title 28, United States Code, Sections 1291 and 1294 and Rule 37(a) of the Federal Rules of Criminal Procedure.

1/ "C.T." refers to Clerk's Transcript of Record.

2/ "R.T." refers to Reporter's Transcript of Record.

II

STATUTE INVOLVED

The indictment was brought under 26 U.S.C., Section 7201, which provides in pertinent part as follows:

> "Any person who wilfully attempts in any manner to evade or defeat any tax imposed by this title or the payment thereof shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, shall be fined not more than $10,000 or imprisoned not more than five years, or both, together with the cost of prosecution."

III

QUESTIONS PRESENTED

A. Are there any conditions precedent to the Government's utilization of the bank deposits methods of computing a taxpayer's taxable income?

B. Was there sufficient evidence of wilfulness to sustain appellant's conviction under Title 26, United States Code, Section 7201?

IV

STATEMENT OF FACTS

Appellant Henry Roy, an accountant and a former German attorney, began filing compensation and restitution claims for ex-German nationals in 1949 [Ex. 75, p. 7; R. T. 67]. Appellant filed claims under the German Indemnification Law on behalf of people who had been deprived of their professions, homes and property by the Nazi government.

Clients came to appellant's office in Los Angeles and generally signed a Power of Attorney permitting appellant to receive the award for the claimant [R. T. 78]. As his fee for filing these claims appellant received ten per cent to fifteen per cent of the amount awarded to the claimant. Appellant received the awards either directly from the compensation office in Germany or from a corresponding German attorney [R. T. 80]. If a corresponding attorney was needed to process a more difficult claim, this corresponding attorney received 50% of Roy's usual fee [R. T. 69].

After appellant received notice of an award he would write a letter to the compensation office stating that the particular amount should be transferred to an account in Berlin, or another European city [R. T. 81].

Appellant maintained two bank accounts in Berlin where fees were deposited, the Berliner Bank and the Berliner Disconto [R. T. 88]. The compensation awards were also deposited into a trustee account in Los Angeles. After the awards were deposited

into the Los Angeles trustee account, appellant would write a check to the claimants for the amount of the award less his fee [R. T. 108]. Approximately 98% of the awards forwarded from Germany were deposited into appellant's trustee account at the Security-First National Bank [R. T. 187]. After the client received his award and the amount in the trustee account reached $1,000, appellant had this amount transferred to his personal accountant account at the Security-First National Bank.

Between the years 1950 and 1956 appellant reported the fees earned from German compensation claims on his Federal Income Tax Returns as taxable income [R. T. 211], however, appellant's income tax returns for the years 1958, 1959 and 1960 failed to include these compensation fees.

Commencing in 1957 and continuing through 1960, appellant claimed only 30% of his total business expenses. Appellant stated to his secretary, Mrs. Lewin, that he would claim some of his business expenses in his German tax returns [R. T. 130, 134]. During the three years in question, 1958, 1959 and 1960, appellant never filed an income tax return in Germany or in any other country except the United States [Ex. 75, p. 23]. [3/] Had appellant claimed all of his justifiable business expenses for the years in question, he would have shown an operating loss for each of the years based on the income that he reported.

Appellant was first contacted by Internal Revenue Agent

3/ Refers to Exhibit 75, admitted into evidence.

Breese on April 29, 1960 [R. T. 208]. At that time appellant stated that he had income that he had not reported. Appellant listed various reasons why he did not include this unreported income on his Federal Income Tax Returns. The following are some of the reasons listed [R. T. 212]:

1. Appellant believed that the German Government might tax this money.

2. Appellant believed that he was practicing law illegally in the State of California, and if this word got back to his clients he could be sued for the return of the fees he had earned.

3. Appellant stated that he planned to file an income tax return at a later date with the German Government.

4. Appellant stated that he would report all of these fees in 1962 when his claims business terminated.

Appellant also stated that he felt that these awards were his own compensation and restitution for the wrong that had been done to him by the German Government. At a later date, appellant was asked why he had paid income tax on the fees which he had received for the years 1950 - 1956 if he felt it was non-taxable as restitution or compensation to him or why he at least did not file for a refund. Appellant replied that he did not do so because it was such a small matter [Ex. 75, p. 58].

During Revenue Agent Breese's first interview with appellant, Mr. Roy made available his cash receipts book which recorded among other things fees received from German compensation awards [R. T. 213]. During the course of several interviews with

the agents, appellant supplied them with deposit tickets, bank ledger sheets and a check disbursement ledger [R.T. 227].

On July 26, 1960, subsequent to his first interview with Revenue Agent Breese, appellant, through his attorney Edythe Jacobs, furnished the Internal Revenue Service with listings of his alleged total percentage fee receipts for the years 1957 through 1959 [Ex. 73]. At that time appellant claimed, however, that these fees were excludable from income for these past years. These listings, however, included only those percentage fees which had been paid by clients directly to appellant and those fees which had gone through one of appellant's trustee accounts in Los Angeles, and then into his public accountant accounts at the Security-First National Bank. There was no disclosure made in any of the listings of the existence of appellant's personal bank accounts at the Berliner Bank or at the Berliner Disconto Bank. Furthermore, no disclosure was made of the fact that thousands of dollars of percentage fees had been deposited into these accounts for appellant's benefit for the years in question by his German correspondent attorneys.

Special Agent James Donley first interviewed appellant on January 10, 1961 [R.T. 275]. At that time Agent Donley advised appellant that a criminal investigation was being undertaken and that appellant need not turn over any records or make any statements if he did not desire to do so. Appellant was also told that he could have an attorney present if he so desired [R.T. 277]. At this time appellant stated that one of his reasons for failing to report

the fees earned from the German compensation awards on his Federal Income Tax Returns was because some of these fees had to be refunded. Appellant stated that he had had to refund between 10% and 15% of the fees which he had earned by reason of the fact that the German Government had countermanded some of his client's claims [R. T. 278]. Agent Donley asked appellant if he would give the Agents a list of the countermanded claims or a list of the people whose claims had to be refunded. However, appellant never gave the agents a list of the fees that were countermanded by the German Government. During a subsequent examination of appellant's bank deposit records, Agent Donley was never able to find any indication that 10% to 15% of appellant's fees had been countermanded by the German Government [R. T. 330].

During this first interview with appellant, Agent Donley received from Mr. Roy a summary of cash receipts that had been deposited into appellant's personal business account at the Security-First National Bank. Appellant also gave Agent Donley copies of the cash disbursement records of 1956 through 1960. Appellant also turned over to Agent Donley some deposit tickets to appellant's personal accountant account [R. T. 279, 280]. Later that same afternoon, Agent Donley telephoned appellant and asked him if he used any work sheets in the preparation of his income tax returns. Appellant stated that he used no work sheets to prepare his income tax returns but that his returns were based upon his cash disbursement records or check records. Appellant further stated that from the records supplied to the agents they could re-construct the

returns exactly in the fashion that appellant had done so [R. T. 280, 281].

During this first interview between Agent Donley and the appellant, Agent Donley asked appellant whether he had any other personal accounts other than the account at the Security-First National Bank. Appellant responded that he had no other personal accounts whatsoever [R. T. 283]. On December 7, 1962, appellant accompanied by his attorney, Edythe Jacobs, appeared in the office of the Intelligence Division of the Internal Revenue Service. At that time appellant was asked whether he had any bank accounts whatsoever other than the two trustee accounts at the Bank of America and at the Security Bank in Los Angeles and his personal account at Von Der Heydt Kersten Sohne in Germany. Appellant responded that he had no other bank accounts whatsoever [Ex. 75, p. 32].

Appellant was asked by Agent Donley whether in connection with his claims processing business appellant used any corresponding attorneys or intermediaries in Germany. Appellant stated that he used none whatsoever [R. T. 298].

During the course of the investigation the agents prepared schedules of the deposits made to appellant's personal accountant accounts for the years 1956 through 1959. Appellant personally identified the sources of each deposit. Appellant supplied the agents with a sheet called a "Legenda" in which appellant identified the sources of the items deposited [R. T. 303, Ex. 46].

Appellant stated to Agent Donley that he had prepared his

income tax returns from the deposits that had been made to his personal accountant account at the Security-First National Bank. Appellant further stated that the totals that were shown on the spreads prepared by the Agents and which he had specifically identified totalled more than he had reported as taxable income on his tax returns. Appellant stated that the items shown on the spread prepared by the Agents were correct [R. T. 306].

On July 14, 1961, subsequent to appellant's first interview with Revenue Agent Breese, appellant filed his joint tax return with the Internal Revenue Service and as an attachment thereto appellant listed his alleged total percentage fee receipts for the year 1960 claiming such fees to be excludable from income. Appellant, however, included only those percentage fees which had been paid directly by clients to appellant and those fees which had gone through one of appellant's trustee accounts in Los Angeles, California. There was no disclosure whatsoever of the existence of appellant's personal bank accounts at the Berliner Bank or at the Berliner Disconto Bank, nor was there disclosure of the fact that thousands of dollars of percentage fees had been deposited into those accounts for appellant's benefit by his German corresponding attorneys in the year 1960.

On August 26, 1963, Agent Donley again interviewed appellant. At this time Agent Donley presented a photostatic copy of two bank accounts, one from the Berliner Bank and the other from the Berliner Disconto Bank, both in Berlin, Germany. At this time, appellant, after some hesitation, admitted that they

were in fact his accounts. Agent Donley asked appellant what items were deposited into these two German bank accounts. At first appellant stated that they were fees from a number of different special transactions. Agent Donley asked appellant to describe the kinds of transactions involved and finally appellant stated that they were fees [R. T. 312, 314]. Agent Donley asked appellant why he had never told the Agents about these foreign bank accounts when he had been asked about them before. Appellant stated that at the time he had been asked about them before there was a seizure placed upon these accounts by the German Government. Appellant further stated that the seizure took place in March or April of 1963. Appellant was first asked what bank accounts he had as early as Agent Donley's first intereview on January 10, 1961 and again on December 7, 1962.

At the time that Agent Donley presented the photostatic copies of the two Berlin bank accounts to appellant, Internal Revenue Agent Breese pointed out a notation appearing in the upper right hand corner of the account and asked appellant if he would translate it for the Agents. Appellant stated that the notation said "To be held for the benefit of Dr. Roy" [R. T. 313]. Agent Donley then asked appellant whether the notation was Dr. Roy's instruction to the bank to transfer certain funds out of those banks to bank accounts in Switzerland. Dr. Roy stated that was true [R. T. 314].

V

SUMMARY OF ARGUMENT

A. THE APPELLEE DID NOT ERR IN ITS USE OF THE BANK DEPOSIT METHOD OF COMPUTING APPELLANT'S TAXABLE INCOME.

1. Appellant Is Estopped From Challenging The Method By Which The Government Determined The Accuracy Of His Unreported Taxable Income Due To His Stipulation That He Had Received Unreported Receipts Equal To The Amounts Alleged In The Indictment.

2. There Are No Conditions Precedent To The Utilization Of Alternative Methods Of Computing Taxable Income.

3. The Appellee's Computations Of Appellant's Taxable Income Were Based On Adequate Books And Records.

B. THERE WAS SUFFICIENT EVIDENCE OF WILFULNESS TO SUSTAIN APPELLANT'S CONVICTION.

VI

ARGUMENT

A. THE APPELLEE DID NOT ERR IN ITS USE OF THE BANK DEPOSIT METHOD OF COMPUTING APPELLANT'S TAXABLE INCOME.

1. Appellant Is Estopped From Challenging The Method By Which The Government Determined The Accuracy Of His Unreported Taxable Income Due To His Stipulation That He Had Received Unreported Receipts Equal To The Amounts Alleged In The Indictment.

Prior to trial appellant stipulated to the correctness of the amounts alleged in the indictment. Stipulations Numbers 3, 4 and 5, as found on page 2 of the "First Stipulation of Facts and Exhibit Register", filed with the District Court on March 14, 1966, stated as follows:

> "3. That all of the exhibits listed herein, which purport to be photocopies of original records of the defendant, of the several banks where he held personal accounts or trustee accounts, records of stock brokerage accounts in the name of the defendant and his wife, or of Federal income tax returns as filed by the defendant may be received in evidence, without further proof of foundation, genuineness, or authenticity, in lieu of the original documents of which they purport to be copies; and that such

exhibits shall be deemed to be proof of the matter asserted therein.

"4. That each of the schedules listed herein and designated as having been prepared by Internal Revenue Agents, containing reconciliations and adjustments, summaries, listings, schedules or analyses, may be received into evidence without further proof of foundation, genuineness or authenticity, as being accurate and true as to the computations and representations of fact which they purport to contain.

"5. That with reference to the terms 'income' and 'taxable income' as may be used in this Stipulation and in any of the listed exhibits, except as in the defendant's income tax returns (i.e., Exhibits 1 - 5, inclusive) it is stipulated only that such amounts were received by the defendant and either reported or not reported on the defendant's income tax returns as shown in any such exhibit, and not to the legal conclusion that such monies were in fact 'income' or 'taxable income'."

The above quoted stipulations and the trial record clearly show that there never was any issue as to the amounts of money alleged in the indictment to be unreported. The only issues litigated were (1) the characterization of the amounts received as taxable or non-taxable and (2) whether the appellant wilfully intended to evade the payment of income taxes on the unreported receipts.

The potential danger arising from the Government's utilization of the bank deposit method of proof is that such a method of proof will not reasonably reflect the income of the taxpayer. United States v. Riganto, 121 F. Supp. 158, 161 (D.C. Virg. 1954). By stipulating to the correctness of the amounts alleged in the indictment appellant has removed this potential danger. Since the unreported receipts were received and deposited by the appellant as proven by the stipulations, the appellant could not possibly be placed in danger through the method used by the Government to determine such stipulations and conclusions.

Appellant makes the contention that his clients' cards, which he failed to produce at the trial, adequately and accurately reflect his income from his compensation business. Appellant did, however, stipulate as to the correctness of the amount of unreported receipts alleged in the indictment as proved by the bank deposits method. If appellant is not estopped from now challenging the correctness of those figures (for that is what he is now attempting to do by challenging the method of their computation) then surely appellant's failure to produce his clients' cards at the trial gives rise to the presumption that had these clients cards been examined they would have disclosed even a greater amount of unreported income than did appellant's cash receipts and cash disbursement records.

In a similar factual situation where the taxpayer asserted that the net worth method of computing taxable income was unwarranted unless his records were first shown to be totally

inadequate and where the taxpayer had possession of such records and yet failed to introduce them in evidence the 8th Circuit held that:

> "Here the rule may be invoked that the failure of a party to introduce evidence within his possession gives rise to the presumption that, if produced, it will be unfavorable to him."
>
> Hoffman v. Commissioner, 298 F. 2d 784, 788 (8th Cir. 1962).

If appellant's client cards had reflected less unreported income than did his bank deposits, then surely these cards would have been introduced in rebuttal to the Government's figures. The fact that the case at bar was a criminal tax fraud prosecution with the attendant burdens of proof, rather than a deficiency suit in the Tax Court should not preclude the operation of the presumption:

> "While, of course, the burden of proof does not shift in a criminal case, it is the rule that when the government establishes a prima facie case, it is then for the defendant to overcome the inferences reasonably to be drawn from the proven facts. Thus, evidence of unexplained funds or property in the hands of a taxpayer establishes a prima facie case of understatement of income, and it is then incumbent on him to overcome the logical inferences to be drawn from such proof. U. S. v. Hornstein, 7th Cir., 176 F. 2d 217, 220."

It is submitted that the only party that might have been injured by the Government's utilization of the bank deposit method of proving taxable income was the Government in that appellant's client cards might have reflected even a greater amount of unreported income with greater attendant tax liability.

2. There Are No Conditions Precedent To The Utilization Of Alternative Methods Of Computing Taxable Income.

There is no prerequisite to the use of circumstantial evidence in tax cases. The Government is free to use all legal evidence available to it. Holland v. United States, 348 U.S. 121, 132 (1954). It may, therefore, resort to a net worth or bank deposits method of proof without first proving the defendant's books and records to be inadequate; by the same token it may resort to such proof without a prior determination by the Revenue Service under Section 446, Internal Revenue Code of 1954, that the defendant's accounting methods do not clearly reflect income. Holland v. United States, supra, at page 132.

In the Holland case, supra, the Supreme Court considered and specifically rejected the rule contended for by appellant in the case at bar:

> "Petitioners ask that we restrict the Johnson case to situations where the taxpayer has kept no books. They claim that §41 of the Internal Revenue Code, expressly limiting the authority of the Government to deviate from

the taxpayer's method of accounting, confines the net worth method to situations where the taxpayer has no books or records or where his books are inadequate. Despite some support for the view among the lower courts (see U. S. v. Riganto, 121 F. Supp. 158, 161, 162), . . . citing other cases, we conclude that this argument must fail."

Holland v. United States, supra, at page 131 (Emphasis added).

All of the Circuit Courts of Appeal that have considered the Holland case have interpreted appellant's point unanimously. The reports are replete with holdings that there are no conditions precedent to the Government's utilization of the net worth or bank deposits method of proof.

In Hoffman v. Commissioner, supra, at page 786 (8th Cir. 1962), it was stated:

"The taxpayer insists that unless there are no records, or that the records are totally inadequate, or where there is a strong suspicion that the taxpayer has received income from undisclosed or illegal sources, the use of the 'cash expenditure' method of determining income is capricious, arbitrary and unwarranted. In view of Holland v. U. S., 348 U.S. 121, 130-132 . . . citing other cases, this argument may no longer prevail."

In Hargis v. Godwin, 221 F. 2d 486, 491 (8th Cir. 1955),

the 8th Circuit held:

"It is now well settled that the net worth method may properly be used even though the taxpayer's books are not inadequate."

To the same effect see:

Canton v. United States, 226 F. 2d 313, 322 (8th Cir. 1955);

United States v. Doyle, 234 F. 2d 788, 793 (7th Cir. 1956);

Davis v. United States, 226 F. 2d 331, 335 (6th Cir. 1955), cert. denied 350 U.S. 965.

Finally, it has been stated:

"The Holland decision makes it clear that there are no conditions precedent to the utilization of the net worth technique."

Davis v. Commissioner, 239 F. 2d 187 (7th Cir. 1956), cert. denied, 353 U.S. 984.

3. The Appellee's Computations Of Appellant's Taxable Income Were Based On Adequate Books and Records Specifically Identified By The Appellant.

Although the case at bar was labeled as a "bank deposit" case at the time of trial, appellee submits that the method of proof utilized by the Government was far different from that utilized in the classical bank deposits case. The Government did not rest its

case on the sometimes dangerous approximations and circumstantial inferences of a net worth or bank deposit computation. See Holland v. United States, supra, at pages 135, 136. In effect the Government's method of proof could well be termed "quasi specific item".

There can be no doubt that the figures relied upon by the Government were accurate because the characterization of the numerous items reflected in appellant's books respecting deposits to his personal account at the Security First National Bank were specifically identified by appellant as to amount and source [R. T. 306]. Furthermore, the agents accepted appellant's figures as correct [R. T. 327].

The testimony of Agent Donley indicates the records which appellant turned over for examination:

> "Q. Did you obtain any records at all from Dr. Roy while you were there, sir? (Referring to interview of January 10, 1961.)
>
> "A. Yes, sir, I did. I had explained to Dr. Roy that what we would like to do would be to reconstruct his income as filed on his returns, or in connection with that he gave me his -- it was a summary of cash receipts which -- not cash receipts exactly, it was a summary of receipts that had been deposited into his personal business account.
>
> "He also gave me -- this is for '56 through '60. He also gave me copies of the cash disbursement records, or check registers of '56 through '60.

"I believe he also gave us some deposit tickets to his personal account." [R.T. 279, 280].

While it is true that Agent Donley did request records from which to reconstruct appellant's income as filed on his returns, it is interesting to note that the records turned over showed income far in excess of the amount reported on appellant's returns. Thus, it was the appellant himself who specifically identified the amount and source of the bank deposits and it was the appellant himself who changed the Government's method of computation from one reflecting only circumstantial inferences to the method utilized by the taxpayer himself.

B. THERE WAS SUFFICIENT EVIDENCE OF WILFULNESS TO SUSTAIN APPELLANT'S CONVICTION.

To establish an attempted evasion of income tax liability wilfulness must be shown. This wilfulness involves a specific intent. The required specific intent may be inferred from the manner in which an individual handles his business affairs or from any conduct, the likely effect of which would be to mislead or to conceal.

Spies v. United States, 317 U.S. 492 (1943).

Direct proof of a defendant's intent to evade is rarely to be found. It may, however, be inferred from all the facts and circumstances attending the preparation of an understatement of net

income and tax by the taxpayer.

> Spies v. United States, supra, at page 499;
>
> United States v. Comerford, 64 F. 2d 28, 30 (2nd Cir. 1933), cert. denied, 289 U. S. 759;
>
> Norwitt v. United States, 195 F. 2d 127, 132 (9th Cir. 1952), cert. denied, 344 U. S. 817.

In the case at bar appellee submits that the record discloses an abundance of conduct on the part of the appellant, the likely effect of which was to mislead the Internal Revenue Agents and to conceal large amounts of unreported income.

The following chronology of appellant's conduct should serve to illustrate his wilfull attempt to conceal income and the payment of taxes thereon.

1. From 1950 through 1956 appellant reported the percentage fees which he earned from his German compensation business on his federal income tax return. However, once his income from the compensation business reached into the 75% bracket appellant conveniently neglected to report these percentage fees as income.

2. On July 26, 1960, subsequent to appellant's first interview with the Internal Revenue Service, appellant, through his attorney Edythe Jacobs, furnished the Internal Revenue Service with listings of his alleged total percentage fee receipts for the years 1957-1959 [Ex. 73]. At that time appellant claimed that the percentage fees were excludable from income. The listings of the percentage fees, however, only included those percentage fees

which had been paid directly to appellant by clients and those fees which had gone through one of appellant's trustee accounts in Los Angeles, California, and then into his public accountant account at the Security-First National Bank. There was no disclosure made of the existence of appellant's German bank accounts or of the fact that thousands of dollars of percentage fees had been deposited into those accounts.

3. On July 14, 1961, appellant filed his joint income tax return and as an attachment appellant listed his alleged total percentage fee receipts for the year 1960. At that time appellant claimed that the fees were excludable from income for that year. The listing, however, again only included those fees which had gone through appellant's trustee accounts in Los Angeles, California. There was no disclosure made of appellant's German bank accounts or of the percentage fees that had been deposited into such accounts.

4. On May 10, 1962, while appellant was being interviewed by Agent Donley he was asked whether he used any corresponding attorneys in connection with his claims processing business. Appellant stated that he used none whatsoever [R. T. 298].

5. During the course of the investigation commencing on April 29, 1960, appellant steadfastly denied that he had any other bank accounts outside of his accounts in Los Angeles and at the Von Der Heydt Kerster Sohne in Germany. It was not until appellant was shown photostatic copies of the Berlin bank account ledgers on August 26, 1963, that he admitted that these were in fact his accounts. After admitting that these accounts were his appellant

was asked what items were deposited into those two Berlin accounts. Appellant replied that they were fees from a number of special transactions. After appellant was asked to describe the kinds of transactions he finally stated that the accounts contained percentage fees from the compensation awards.

Appellant was also asked to translate the notation appearing on the Berlin Bank ledger sheets. Appellant stated that the notation read "To be held for the benefit of Dr. Roy". Thereafter, through the prompting of Agent Breese, appellant admitted that the notation was an instruction to transfer those funds to a bank account in Switzerland.

6. During appellant's first interview with Agent Donley on January 10, 1961, appellant stated that one of the reasons that he failed to report his percentage fees as income was that 10% to 15% of these fees had been countermanded by the German government. During the course of the investigation Agent Donley was never able to locate any checks made payable to clients that were identified as being refunds because of countermanding orders [R.T. 330].

7. Appellant stated to Revenue Agent Breese during their first interview that one of the reasons that he failed to report his percentage fees as income was that he feared that he was practicing law illegally in California and that his clients could sue him for refunds of his fees. Yet Exhibit 72, admitted into evidence, is a letter from his attorney Edythe Jacobs wherein she stated that, as a result of inquiries made with the State Bar of California, she

did not believe that appellant was practicing law illegally or that it was necessary to be a member of the State Bar of California to represent persons before administrative agencies.

8. During the years in question appellant utilized only 30% of his justifiable business expenses. The reason for this was clearly that had all of his expenses been deducted, based on his reported income he would have shown an operating loss for the years in question. Furthermore, appellant told Mrs. Lewis that he would file an additional tax return with the German government because taxes were not so high there [R. T. 130-134]. During the years in question appellant never filed an income tax return in Germany.

VII

CONCLUSION

On this appeal appellant challenges the Government's utilization of an alternative method of computing the taxpayer's unreported taxable income, namely, the bank deposit method. However, it is apparent that appellant does not challenge the bank deposit method of proof for any of the time-honored and justifiable reasons, i. e., that the Government's proof did not reasonably reflect the income of the taxpayer and that the Government is relying on dangerous approximations and circumstantial inferences. This issue was taken out of the case prior to trial by virtue of appellant's stipulations as to the correctness of the amounts of

unreported income alleged in the Indictment.

The heart of appellant's appeal is directed toward the proposition that the Government's utilization of the bank deposit method generated a lengthy investigation during which appellant, of his own free will and volition made numerous false and fraudulent statements in an attempt to conceal income which he had failed to report on his income tax returns for the years in question.

Thus, it appears to be appellant's contention that the Government's method of proof was too thorough, that it uncovered too much. Appellant's argument would seem to prove too much. Should the Government be reprimanded because its investigation turns up over a quarter of a million dollars in unreported income? Certainly the Government is not limited to that method of proof which uncovers the least amount of unreported income and fails to expose a wilfull concealment of income.

The Government must be free to use all legal evidence available to it in determining whether a taxpayer has unreported income. Furthermore, the Government should not be precluded from the use of proper investigative techniques to determine whether there was a wilfull attempt to conceal income.

It must be noted that many of the false statements made by appellant in this case were made in the presence of his attorney. It was not the Internal Revenue investigation which generated appellant's damaging admissions. The statements were made subsequent to appellant's concealment of substantial amounts of unreported income. The statements were merely appellant's last

attempt to extricate himself from a situation which he had created for himself without the assistance of the Internal Revenue Service.

For the foregoing reasons, it is respectfully submitted that the judgment of conviction of appellant Roy should be affirmed.

Respectfully submitted,

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United States of America.

CERTIFICATE

I certify that in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

/s/ Anthony Michael Glassman

ANTHONY MICHAEL GLASSMAN
Assistant United States Attorney

No. 21081

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

HENRY ROY,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

On Appeal From the Judgment of the District Court of the United States, Southern District of California, Central Division.

APPELLANT'S REPLY BRIEF.

FILED

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APPELLANT'S REPLY BRIEF.

Introduction.

The argument which follows is entirely in reply to arguments advanced by appellee in its brief. An observation is appropriate before replying to Appellee's Brief to note what appellee did *not* dispute therein.

The Government has concerned itself solely with the concept of *adequacy* of books and records when establishing justification for use of circumstantial evidence in a criminal tax case — appellee has not responded to appellant's contention that the investigating agents, and the courts, should first look to the *accuracy* of the taxpayer's books and records before blindly resorting to the use of such evidence. Such a response is understandable as the appellee cannot dispute the major points upon which the appellant relies. The taxpayer

apparently maintained accurate books and records (or at least the Government could not prove that the records were inaccurate) and the investigating agents never requested or examined the available records.

The appellee also claims that the appellant was not harmed by use of the bank deposits method, or in the alternative, that this harm was of his own making. The evidence does not support the first contention, and the second does not apply to a taxpayer who disclosed to the Revenue Agent that items of receipt were not reflected in his tax returns, only to have three investigating agents thereafter conduct an examination which did not even consider the available records which presumably reflected all receipts for the years in question.

ARGUMENT.

A. Reply to Argument That Appellant Has Stipulated to Amount of Unreported Income.

The Government contends that the appellant has stipulated to facts which in and of themselves are sufficient to sustain the finding of the lower court. This argument ignores the scope of the Stipulations in question, the rationale for those Stipulations, and indeed, the workings and fallacies of the bank deposit method when establishing an understatement of income.

Through Stipulation No. 3, the Government was permitted to introduce photocopies of bank records indicating deposits in several banks, etc., without establishing foundation for the admission of the photocopies. In Stipulation No. 4, the schedules prepared by the Internal Revenue Agents, based upon the aforementioned photocopies, were admissible in evidence so as to spare Government counsel the burden of conducting extensive examination of the Agents who prepared said schedules as to the preparation of schedules and the source of each item contained therein.

In Stipulation No. 5, the parties clearly state that the defendant is merely stipulating to the receipt of funds, and the deposit of funds in specific banks while making it clear that the defendant is not in any manner categorizing such receipts or deposits as taxable income. The burden remained upon the Government to establish the fact of, and amount of defendant's alleged unreported income.

The defendant entered into the above Stipulations for the purpose of saving the Court many additional days of trial. It was not necessary for the Government to lay foundation for the admissibility of several bank accounts, including three German bank accounts, and the Revenue Agents' schedules and work sheets were also admitted into evidence without the necessity of establishing foundation. None of the Stipulations relieved the Government of its burden of establishing an understatement of *taxable income.* [Stip. 5.]

An admission of the receipt of funds in a particular bank account does not establish that said receipt constitutes taxable income. The term "receipt" is not equated to "income." This is so even if the Government establishes that the taxpayer had no taxable free sources of income. The most obvious danger encountered when using the bank deposits method is that a particular deposit might be a transfer from another bank — therefore clearly nontaxable — yet included as two receipts of income when there was in fact but one. The appellant established in his Opening Brief (p. 28) that neither investigating agent was able to state that inter-bank transfers had been eliminated. This was particularly true with respect to the transfer of funds from the German banks to the Los Angeles banks. This factor not only bears upon the amount of unreported income in this case, but raises questions as to the validity of an essential element relied upon by the Government to establish wilfulness.

The Government is apparently contending (Br. pp. 15-17) that the appellant could have shown that the Government's determination was incorrect by introducing his books and records into evidence during trial. The Government has the burden of establishing each element of the crime beyond a reasonable doubt, and its case must be established through methods which are most likely to bring the true facts before the Court. The Government may not introduce evidence of questionable reliability before the Court in hopes of establishing its case in chief; it is obligated to present that evidence which will best demonstrate the omission of taxable income during the years in question, and establish the element of wilfulness. An analysis of the cases cited by the Government demonstrates that they are not authority for its position.

In *Hoffman v. Commissioner* (8th Cir., 1962), 298 F. 2d 784, 788, cited at page 16 of Appellee's Brief, the Court was reviewing a decision of the Tax Court, and found that the defendant was required to make an affirmative showing because:

> "This is so, because Rule 32 of the Rules of Practice of the Tax Court, as well as the Supreme Court in *Welch v. Helvering,* 290 U.S. 111, 54 S. Ct. 8, 78 L. Ed. 212 and *Helvering v. Taylor,* 293 U.S. 507, 508, 55 S.Ct. 287, 79 L.Ed. 623, state that the Commissioner's determination of deficiency in tax bears a presumption of correctness, and the burden of proof is upon the petitioner to show error therein."

In *United States v. Hornstein* (7th Cir., 1949), 176 F. 2d 217, the defendant was contending that the Government had not established that there was a deficiency in tax for the years in question. The Government had apparently proved through specific omitted items that the taxpayer's gross receipts were understated. The

question facing the lower court was that of arriving at a reasonable cost of sales for those items which were sold but not reported in the defendant's books and records. The defendant apparently took the witness stand and tried to place the responsibility for the inaccuracy of his books upon his wife who was dead, and upon a cousin whose whereabouts was unknown. He offered evidence to the effect that his cost of goods sold for those items which were not reflected in gross receipts was higher than the sales price of said items. The Court did not believe his story.

We are of course here concerned with a criminal case.

> "The presumption of innocence attaches to an accused defendant at the beginning of a trial and remains with him throughout the trial of the cause. It never shifts." *Brubaker v. United States* (6th Cir., 1950), 183 F. 2d 894, 898.

The burden is upon the Government to prove each element of its case beyond a reasonable doubt, through methods which are geared to produce the most reliable evidence available.

The Fifth Amendment to the United States Constitution provides that a person need not be a witness against himself in a criminal proceeding. Title 18, Section 3481 of the United States Code provides:

> "In trial of all persons charged with the commission of offenses against the United States and in all proceedings in courts martial and courts of inquiry in any State, District, Possession or Territory, the person charged shall, at his own request, be a competent witness. *His failure to make such request shall not create any presumption against him.*" (Emphasis added.)

The Government is urging that the defendant's failure to testify and produce evidence on his behalf as to

the correct understatement of income is to cast credibility on the Government's case. This argument ignores the Government's burden of proof. If the Government's case in chief is established through improper methods, the defendant need not demonstrate that the facts allegedly proved by that method are incorrect. The Government's contention also ignores 18 U.S.C. 3481, quoted above, and the rule against comment on a defendant's failure to testify as stated in *Wilson v. United States,* 149 U.S. 60, 13 S. Ct. 765, and *Griffin v. State of California* (1965), 380 U.S. 609, 613, 85 S. Ct. 1229, 1232. The "prosecutor" is now arguing on appeal that the defendant's failure to testify and present evidence in his favor gives weight to that evidence offered by the prosecutor, when in fact such an argument is not permitted before a jury. Such an argument is clearly improper and should be ignored by this Honorable Court.

B. Reply to Argument That There Are No Conditions Precedent to Use of the Deposits Method.

In reply to the Government's contention that, "There are no conditions precedent to the utilization of alternative methods of computing taxable income," a brief introductory statement is necessary before analyzing the Government's "authority" for its position.

Is the Government in fact contending that an Internal Revenue agent may audit any taxpayer without making use of the books and records maintained by that taxpayer? Counsel can envision a situation where an investigating agent knocks on the taxpayer's door and states that he is auditing the taxpayer's return for a specific year. The agent then requests all of the taxpayer's bank records, including all deposits slips and canceled checks, and demands all invoices and other records describing assets which the taxpayer may have pur-

chased or sold within a specific period of years. He then would presumably be free to reconstruct the taxpayer's income through use of the bank deposits and net worth methods, without referring to the taxpayer's books and records for explanations of specific items, and without compulsion to contrast his tentative conclusions with the financial picture as set forth in the taxpayer's records.

The Government is contending that such an audit would be permissible, and that the results of that audit could be the basis for a criminal prosecution notwithstanding the fact that the agent had not referred to those documents which presumably most accurately reflect the taxpayer's income — his books and records.

Counsel for appellant are aware of the fact that Internal Revenue agents must be allowed a great deal of flexibility and latitude in conducting their audits so that they may match their initiative and imagination against that of the potential tax evader. However, there must be some ground rules setting minimum standards for a tax investigation. Counsel suggests that one such standard is that the investigating agent must review all records of the taxpayer which presumably reflect his financial transactions — his books and records, in the broadest sense. The agent is then free to attempt to demonstrate the inaccuracy of those records by any reasonable means, such as the bank deposits or net worth methods. The taxpayer's books and records must be recognized as the taxpayer's reflection of his income and expenses for the year; these foundation documents can be questioned and attacked, but they *must* be reviewed, analyzed, and weighed against the results of the agent's independent investigation.

The taxpayer is required under the 1954 Internal Revenue Code, Section 6001, to keep such records as

the Treasury regulations may provide. Tres. Reg. §1.6001-1 provides in part:

> "(a) IN GENERAL. Except as provided in paragraph (b) of this section, any person subject to tax under subtitle A of the Code, or any person required to file a return of information with respect to income, shall keep such permanent books of account or records, including inventories, as are sufficient to establish the amount of gross income, deductions, credits, or other matters required to be shown by such person in any return of such tax or information.
>
> . . .
>
> "(e) RETENTION OF RECORDS. The books or records required by this section shall be kept at all times available for inspection by authorized internal revenue officers or employees, and shall be retained so long as the contents thereof may become material in the administration of any internal revenue law."

The taxpayer is required by law to maintain books and records; investigating agents of the Internal Revenue Service are required by law to examine those books and records. The investigating agents are obviously not bound by the representations found in the books and records, but they are required to examine the records and contrast them with the results of any independent investigation demonstrating a greater taxable income than that reflected in the books.

Upon close inspection, the cases cited by the Government are not in direct opposition to the statement of law propounded by the appellant. It is first important to note that the appellant is not contending that the net worth method may not be used unless a taxpayer's books are inadequate. He is, however, contending that the Government must establish that the

taxpayer's books are *inaccurate* — it cannot conduct an audit and determine an understatement of income without reviewing and analyzing those books and records which are maintained, available, and *presumably* accurate.

The strongest statement in Appellee's Brief is that from *Davis v. Commissioner* (7th Cir., 1956), 239 F. 2d 187, found on page 19 of Appellee's Brief. What does *Davis* really say? The Court first notes (pp. 188-189), that:

> "As to the first question, it is taxpayer's contention that the net worth method may be used notwithstanding the presence of records only where evidence of concealment or falsity exists. The Supreme Court has expressly held, however, that the net worth method is not confined to situations where the taxpayer has no books or where his books are inadequate. *Holland v. United States,* 348 U.S. 121, 130-132, 75 S. Ct. 127, 99 L.Ed. 150. Taxpayer's argument is the same argument rejected by the Court in the Holland case for concealment and falsity necessarily impugn the adequacy of a taxpayer's books."

The Court then notes, at page 189:

> "*Furthermore, the Tax Court found that taxpayer's records were not adequate and this finding is well supported by the evidence.*" (Emphasis added.)

The Court's rational for stating that there are no conditions precedent to the utilization of the net worth technique is found immediately before the quotation in Appellee's Brief, and explains that statement:

> "In short, *the apparent adequacy of the taxpayer's books is the very thing that the net worth method attacks by independently demonstrating the receipt of unrecorded and unreported taxable income.*" (Emphasis added.)

The Court in *Davis* therefore found that the net worth method could be used to demonstrate the *inaccuracy* of the taxpayer's books and records. The case before this Court is one where the books and records maintained by the taxpayer were ignored throughout the investigation and trial of the case. Such was not the case in *Davis.*

The same distinctions are found in *Hoffman v. Commissioner* (3rd Cir., 1962), 298 F. 2d 784, 786, 787. In that case the Court noted:

> "The above books and records were incomplete, inadequate and in no wise covered the entire transactions involved over the years in question. The Commissioner *after inspecting the records of the petitioner* discovered that the cash expenditures for the years involved were substantially in excess of the net income reported, although he did not assert that he found any false items in the petitioner's books of account.
>
> . . .
>
> "Here, the Tax Court found that the Commissioner did everything that was possible for him to do, *in addition to examining the meager books and records of the petitioner,* he examined the tax returns of the taxpayer which were put in evidence for the years 1927 to 1947." (Emphasis added.)

In reviewing recent cases dealing with the use of the net worth method, the following statement was found in the initial sentence discussing the use of the net worth method in the case of *United States v. Fernicola* (3rd Cir., 1966), 361 F. 2d 864:

> "Since the Government was unable to obtain from the defendant books or records of his medical practice reflecting the payments of fees to him, it arrived at its calculations of the defendant's taxable income for the years involved via the 'net worth' method and prosecuted its case at the trial in accordance therewith. (Citations)"

Counsel suggest that each member of this Honorable Court who has written an opinion involving the use of the net worth method of computing taxable income has made a statement similar to that quoted above. It would be unnecessary to make such a finding if there were no conditions precedent to the use of the net worth method. Appellant has presented in his Opening Brief (pp. 11-14) the dual use of the bank deposits and net worth methods. Such methods are first used to test the taxpayer's books and records, and then may serve as evidence of unreported income. This rule was in fact restated in *Hoffman v. Commissioner of Internal Revenue, supra,* cited by appellee as authority for a contrary doctrine.

Both the Government and the appellant recognize the case of *Holland v. United States* (1954), 348 U.S. 121, 75 S. Ct. 127, as being the leading case in defining the use of the net worth method of reconstructing income. The appellee is contending that *Holland* opens the door for the Government to reconstruct a taxpayer's income without the existence of any conditions precedent. The appellant is urging that the Government must reconstruct a taxpayer's income for the purpose of contrasting the reconstructed income with that shown in the taxpayer's books and records, and then ask that the higher figure be accepted as correct.

There are many indications in the *Holland* case that the appellant's interpretation is correct. The Court first points out the well-established fact that:

> "Unlike civil actions for the recovery of deficiencies, where the determinations of the Commissioner have prima facie validity, the prosecution must always prove the criminal charge beyond a reasonable doubt." (75 S. Ct., at 130, 348 U.S. at 126.)

The Court then warns (75 S. Ct., at 132, 348 U.S., at 129):

> "While we cannot say that these pitfalls inherent in the net worth method foreclose its use, they do require the exercise of great care and restraint. The complexity of the problem is such that it cannot be met merely by the application of general rules. (Citation) Trial courts should approach these cases in the full realization that the taxpayer may be ensnarled in a system which, though difficult for the prosecution to utilize, is equally hard for the defendant to refute. Charges should be especially clear, including, in addition to the formal instructions, a summary of the nature of the net worth method, the assumptions on which it rests, and the inferences available both for and against the accused. *Appellate courts should review the cases, bearing constantly in mind the difficulties that arise when circumstantial evidence as to guilt is the chief weapon of a method that is itself only an approximation.*" (Emphasis added.)

The appellant herein is challenging the ability of the Government to proceed by use of an indirect method of determining taxable income without first thoroughly reviewing the available books and records of the taxpayer. The following language of the Supreme Court in *Holland* bears heavily in weighing this issue (75 S. Ct., at 135, 348 U.S., at 135-136):

> "While sound administration of the criminal law requires that the net worth approach — a powerful method of proving otherwise undetectible offenses — should not be denied the Government, its failure to investigate leads furnished by the taxpayer might result in serious injustice. It is, of course, not for us to prescribe investigative procedures, but

> it is within the province of the courts to pass upon the sufficiency of the evidence to convict. *When the Government rests its case solely on the approximations and circumstantial inferences of a net worth computation, the cogency of its proof depends upon its effective negation of reasonable explanations by the taxpayer inconsistent with guilt. Such refutation might fail when the Government does not track down relevant leads furnished by the taxpayer* — leads reasonably susceptible of being checked, which, if true, would establish the taxpayer's innocence. *When the Government fails to show an investigation into the validity of such leads, the trial judge may consider them as true and the Government's case insufficient to go to the jury.* This should aid in forestalling unjust prosecutions, and have the practical advantage of eliminating the dilemma, especially serious in this type of case, *of the accused's being forced by the risk of an adverse verdict to come forward to substantiate leads which he had previously furnished the Government.* It is a procedure entirely consistent with the position long espoused by the Government, that its duty is not to convict but to see that justice is done." (Emphasis added.)

Can the Supreme Court, while stating that the Government has the burden of investigating all leads furnished by the taxpayer and negating all nontaxable sources of income, also be stating that the investigating agents may recompute and reconstruct the taxpayer's income without referring to, comparing, or contrasting the taxpayer's books and records with the fruit of their independent investigation? Such a holding would be entirely inconsistent with the Court's warnings of the dangers involved when establishing a tax case by use of circumstantial evidence.

In the recent case of *Lenske v. United States* (9th Cir., 1966), 18 A.F.T.R. 2d 5815, ... F. 2d ...., this Court restated the admonition of the Supreme Court in *Holland v. United States, supra*, concerning the dangers of the use of circumstantial evidence. In discussing the obligation of the investigating agents to investigate all leads, the Court stated:

> "Under the *Holland* teaching, a lead not furnished by the defendant but discovered by the Special Agent in his investigation would have at least equal status with a lead furnished by the defendant. The philosophy of Holland is that the trial of a tax fraud case by the net worth method places a defendant at a disadvantage dangerous to his liberty, and that some departure from the gamesmanship tactics of ordinary trials, even other criminal trials, is necessary to compensate for the disadvantage and make the contest more nearly equal."

The Court later noted:

> "It may be asked what harm is done, after all, by disregarding the admonitions of *Holland,* supra, putting everything into a chart showing increased net worth and having the Special Agent testify that it was prepared under his supervision and is right. There is still opportunity for cross examination and for witnesses for the defense. What is wrong, in addition to its being contrary to the law laid down by the Supreme Court, is that such a process is outrageously unfair . . . *What has happened to him is that the Government has not assumed the burden of proving, beyond a reasonable doubt, that he is guilty. It has assumed only the burden, with its unlimited resources and time, of preparing a mass of documentary evidence and charts incomprehensible to a layman, all prepared*

by the Government itself, and is saying to the taxpayer, 'Your task is to prove that all of what is contained in the charts is false, not merely that it is 96% false, but that it is all false. You do not have the time nor the resources that the government had, but that is your misfortune.' " (Emphasis added.)

C. Reply to "Quasi-Specific Items" and Wilfulness Arguments.

The appellee sets forth an interesting argument beginning on page 19 of Appellee's Brief, to the effect that this case is in reality a quasi-specific items case, rather than a bank deposits case. The appellee bases this argument on the fact that the defendant categorized deposits to his personal account at the Security First National Bank as to amount and source. These admissions, states the appellee, convert this case from a bank deposit case to a specific item case.

There is no question that the defendant attempted to identify bank deposits, at the request of the investigating agents. These deposits indicate an understatement of taxable income. The defendant advised Revenue Agent Breese that certain receipts were not reflected on his tax return, during Agent Breese's first meeting with the defendant. The defendant then claimed that these items of receipt were nontaxable; the Government and the Court disagreed.

The above argument is reasonable at first blush, but is in error when considering the appellee's arguments concerning wilfulness. The vast majority of the evidence pointed to by appellee as establishing wilfulness deals with the German bank accounts, either directly or indirectly. The German bank accounts were not reconciled by the defendant, and the Government claims that

these accounts were sources of additional income that were neither reflected on the tax return nor disclosed to the investigating agents. *Such an analysis indeed makes use of the bank deposits method.* The Agents' audit was inadequate in that it did not establish that the funds deposited in the German bank accounts were not subsequently transferred to the Los Angeles bank accounts and reported as taxable income or initially disclosed to Revenue Agent Breese. This case is in fact a bank deposits case in theory, even though it fails to prove those elements which the Government seeks to establish.

The appellant has argued in his Opening Brief that the continuation of this audit over a period encompassing several years was to appellant's detriment, and that many items relied upon by the Government in establishing wilfulness were generated through the inadequacies of the audit procedures adopted by the Agents. These inadequacies and the detriment suffered by the appellant are evident when considering the fourth item relied upon by appellee as indicating wilfulness. (Appellee's Br. p. 23.) The Government states that appellant failed to disclose that he had corresponding attorneys in connection with his claims processing business during his interview with Agent Donley on May 10, 1962. Yet, two years earlier, on May 27, 1960, during his interview with Revenue Agent Breese and Special Agent Phoebus, Dr. Roy disclosed:

> "He said that in the course of negotiating with people who had a claim against the German government, he would make a fee arrangement with them which would be expressed in writing, that the fee charged the claimants was 10 percent, 5 percent of which was kept by Dr. Roy and 5 percent which went to an attorney which he, Dr. Roy, engaged in Germany." [Tr. p. 259.]

The fact that the Government had not investigated the defendant's relationship with the corresponding attorneys, the fee agreements with said attorneys, and the forwarding of funds from Germany to the United States during the period May, 1960-May, 1962, raises serious questions as to the method and manner of the Agents' investigation. The appellant, of course, claims that he was prejudiced by the failure of the investigating agents to examine the available books and records. Such an investigation would have disclosed facts as that discussed above. The above example clearly demonstrates one specific instance in which the appellant was so prejudiced by the Agents' unwarranted use of circumstantial evidence.

This case presents an excellent example of the dangers encountered when using an indirect method of determining taxable income. In the appellant's Opening Brief (pp. 27-29) the testimony of the Internal Revenue Agent and Special Agent clearly demonstrate they were unable to establish that the funds from the Berlin bank accounts were not subsequently deposited in the Los Angeles bank accounts. This essential element of inter-bank transfers, the most important single factor to consider in a bank deposits case, was not accounted for by the Agents. Let us pause a moment to consider the significance of this fact.

The defendant admitted to Revenue Agent Breese during the initial contact that certain receipts were unreported on the tax return, as the defendant believed that they were tax-free receipts. [Tr. pp. 210-211.] The Government contends that fraudulent intent is demonstrated by the taxpayer's failure to inform the Agents of the German bank accounts at that time. However, the Agents themselves testified that they were unable to establish that the amounts deposited in the German

bank accounts were not subsequently deposited in Los Angeles bank accounts, and thereby reflected in the "Legenda" of receipts prepared by the defendant for the investigating agents. The agent's expressed intent was to reconstruct the tax return. If the question of the German bank accounts was not presented to the Court, it would be difficult for the Court to find the necessary fraudulent intent. The question of the German bank accounts, transfers from those accounts, and the alleged concealment of those accounts colored the entire trial.

If the investigating agents had reviewed and analyzed the available books and records, the entire audit and trial (should the taxpayer have been indicted) would have proceeded in a different fashion. The receipts which were not reflected in the taxpayer's income tax returns would have been ascertained through his books and records, and the sole questions before the Court would have been the taxability of the omitted receipts and the reason for the omission. The audit would have been completed in a matter of weeks, rather than a matter of years, and the taxpayer would not have been subjected to the stress and strain accompanying a lengthy Internal Revenue investigation. The procedural safeguard requested by the appellant — that the investigating agents be required to attempt to determine unreported income by first examining his books and records — would have changed the entire picture painted during the investigation, and viewed during the trial.

Conclusion.

The Government argues, in conclusion, that it should not be prevented from using a method which uncovers the maximum amount of unreported income; which, through its length and "thoroughness," establishes a wilful intent to conceal income. It is significant that the Government speaks in terms of *maximum unreported income* rather than an *accurate determination* of the taxpayer's understatement. This Court is cognizant of the dangers expressed by the Supreme Court in *Holland, supra*, and should join that Court in establishing procedural safeguards so that the Government will seek accuracy rather than maximum determinations of deficiency in future audits. The failure of the investigating agents to examine the defendant's books and records, the meaningless attempt to reconstruct appellant's income as actually reported on the return, the length of the investigation, and the failure to account for inter-bank transfers between the German banks and the Los Angeles banks clearly demonstrate that the investigation neither accurately discloses the actual understatement of income, nor is a reliable bell-weather from which to adjudge the issue of fraudulent intent.

The appellant respectfully requests that the lower court be reversed upon the grounds urged in Appellant's Opening Brief.

Respectfully submitted,

Hochman and Salkin,
By Bruce I. Hochman,
Attorneys for Appellant.

Certificate.

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Bruce I. Hochman

NO. 21088

In the

United States Court of Appeals

For the Ninth Circuit

ROBERT LEWIS BANZER,
Appellant,

vs.

UNITED STATES OF AMERICA,
Appellee.

APPELLANT'S BRIEF

Appeal from the United States District Court for the District of Oregon

HONORABLE JOHN F. KILKENNY, *Judge*

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APPELLANT'S BRIEF

Appeal from the United States District Court for the District of Oregon
HONORABLE JOHN F. KILKENNY, *Judge*

CAUSE OF ACTION

I.

This is a criminal action based upon an Indictment founded by the Grand Jury under Section 18 U.S.C.A. 2314, charging the Appellant with the crime of "Unlawful Transportation of Counterfeit Securities Interstate" in six counts. Appellant entered his plea to each count of Not Guilty and the cause came on regularly for trial.

At the commencement of the trial the United States Attorney moved the Court for an Order to amend the Indictment in Count I changing the date of the alleged forged document from November 24, 1964, to *December*

4, 1964, and changing the amount of the check from $98.27 to *$98.23* and in Count III changing the amount of the check from $98.48 to *$98.46* and in Count V changing the amount of the check from $98.40 to *$98.48*. The court over objections of the Appellant allowed the Motion and the Indictment was amended to reflect the alterations above requested. The Appellant declined to offer any testimony at the conclusion of Appellee's case. The cause was submitted to the Jury resulting in a Verdict of Guilty to all six counts. The Appellant was sentenced pursuant to said verdict, from which sentence this appeal is taken.

PROPOSITION OF LAW

I.

The lower Court erred in permitting Appellee's Motion to Amend said Indictment (Transcript of Testimony Page 1) (United States Constitution Amendment V)

No person shall be held to answer for a capital or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury.

18 U.S.C.A. Sec. 1951

U.S. v. Fawcett, 115 Fed (2d) 764

Steroni v. U. S., 361 U.S. 212, 80 S. Ct. 270, 4 L Ed. (2d) 252, 1959

Ex Parte Bain, 121 U.S. 1, 7 S. Ct. 781, 30 L Ed. 849

Stewart v. U. S., 9 Cir. 12 Fed. (2d) 524
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Where a crime charged is a felony, the law clearly requires prosecution by Indictment. After an Indictment has been returned its charge may not be broadened through amendment except by the Grand Jury itself. The amendment permitted by the Court broadened and altered the Indictment of the Grand Jury so that it was no longer their Indictment, but was an Information of the United States Attorney. Appellant did not waive Indictment by the Grand Jury nor did he agree to proceed on an Information presented by the United States Attorney.

PROPOSITION OF LAW

II.

Error of the Court in overruling Appellant's objections to evidence. Primary evidence is the best evidence. Secondary evidence is admissable only when primary evidence is not available, and under a proper showing. Appellee entered into evidence over the objection of Appellant Secondary evidence, (Appellee's Exhibit 1) consisting of a check similar in some respects to one under discussion which was not a carbon copy of the check in question and no foundation was laid which

permitted the exhibit to be introduced into evidence (Transcript of Testimony pages 5 and 6). The "American Rule" is well established and recognized in virtually all Courts and jurisdictions and is as follows: "Secondary Evidence in order to be admissable must be the best legal evidence obtainable." Diligence must be shown and exercised to obtain the best evidence.

Wigmore on Evidence, 3rd Edition 1268
Am. Jur. Evidence, Sec. 403, 404
Courette v. Williams, 20 U.S. 226, 22 L Ed. 254
Popolia v. U. S., 243 Fed (2d) 437
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PROPOSITION OF LAW

III.

Error of the Court in denying Appellant's Motion for Acquittal (Transcript of Testimony pages 106-107)

Appellant duly moved the Court for an acquittal at the close of Appellee's case, based upon the record which was denied by the Court.

PROPOSITION OF LAW

IV.

Error of the Court in denying Appellant's Motion to Dismiss (Transcript of Testimony page 119)

Upon denial of Appellant's Motion for Acquittal the Appellant rested his case and moved the Court to dismiss the action, which was also denied.

SUMMARY

Appellant takes the position that all proceedings by he Court after allowing the amendment to the Indictnent became a nullity and the Court should have acquitted the Appellant and/or dismissed the action, or at east should have re-referred the matter to the Grand ury for further consideration. The Constitutional Rights of everyone must be preserved and enforced at ill times and particularly as it relates to criminal maters. It is a matter not to be taken lightly and is encumbent upon the Courts to follow to the letter of the law. f the Courts and prosecuting officials are permitted to mend Indictments at will, soon the Constitution would e of no further force or effect.

Respectfully submitted,

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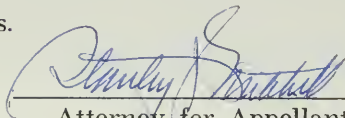
Certificate of Attorney

I certify that, in connection with the preparation of this brief, I have examined rules 18 and 19 of the United States Court of Appeals for the 9th Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.



Attorney for Appellant

NO. 21088

United States Court of Appeals for the Ninth Circuit

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ROBERT LEWIS BANZER,

Appellant,

v.

UNITED STATES OF AMERICA,

Appellee.

On Appeal from the United States District Court for the District of Oregon

BRIEF OF APPELLEE

SIDNEY I. LEZAK,
United States Attorney
District of Oregon

NORMAN SEPENUK,
Special Assistant United States Attorney

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United States Court of Appeals
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ROBERT LEWIS BANZER,

Appellant,

v.

UNITED STATES OF AMERICA,

Appellee.

On Appeal from the United States District Court for the District of Oregon

---

BRIEF OF APPELLEE

COUNTER-STATEMENT OF THE CASE

On October 4, 1965, an indictment in six counts was filed against appellant Banzer in the United States District Court for the District of Oregon. (See Clerk's transcript of record, page 1). The indictment alleged that on or about December 8, 1964, appellant knowingly and willfully caused to be trans-

ported in interstate commerce, to-wit: from Portland, Oregon to Seattle, Washington certain falsely made and counterfeited securities, in violation of Section 2314, Title 18, United States Code. After a trial by jury, appellant was found guilty on each count. On March 9, 1966, appellant was sentenced by the Honorable John F. Kilkenny to a concurrent prison term of five years on each count.

The evidence to support the verdict of guilt may be summarized as follows:

In late 1964, appellant requested Jack Stevenson and David Hildebrand to assist him in setting up a counterfeit check printing and cashing operation in Portland. (R. 4, 9, 59-60) Shortly thereafter, appellant contacted one Ralph Tolle and requested his assistance in starting an "advertising agency" in Portland which was to serve as a base for the counterfeiting operation. (R. 84). At appellant's request, Tolle leased in his own name a printing press and other photographic equipment which was installed by him, appellant and Stevenson in a building in Southeast Portland. (R. 7-8, 85). Appellant utilized the equipment to print a quantity of counterfeit blank checks of the Safeco Lifeco Insurance Company located in Seattle. (R. 11-12, 60-61). After

printing these checks, appellant took them home to his wife, who typed in fictitious dates, payees and amounts. (Exs. 2-7; R. 12-13) In early December, 1964, appellant instructed Stevenson and Hildebrand to go to Seattle and cash the checks, after which appellant was to get an agreed percentage of the proceeds. (R. 16, 61)

Stevenson and Hildebrand, together with a girl by the name of Caroline Young, left for Seattle the next day and cashed the checks at various shops in Seattle by utilizing counterfeit Washington drivers' licenses which had also been printed by appellant. (R. 12, 14-30, 48-55, 61-66). After returning to Portland, Stevenson and Hildebrand turned over a portion of the proceeds of these checks to appellant. (R. 65-67).

ARGUMENT

There Was No Prejudicial Error in the Proceedings Below

1. The trial court correctly granted the government's motion to amend the indictment.

Appellant complains (BR. 2-3) that prejudicial error was committed when the trial court, at the outset of the case (R. 1), granted the government's

pre-trial motion to amend certain wording in three counts of the indictment. Appellant has not and cannot make any assertion that the government did not inform him of these minor errors well prior to trial. Nor has appellant suggested that he was in any way prejudiced by these amendments in preparing his defense. Appellant's sole complaint is that these amendments so "broadened and altered" (BR. 3) the indictment that they could only be made by the grand jury. We respectfully suggest that the argument is so thin as to be almost frivolous. The amendments, which pertained to three counts of a six count indictment, were as follows: the date on the counterfeit check in Count One was changed from November 24, 1964, to December 4, 1964, and the amounts of the counterfeit checks in Counts One, Three and Five were changed from $98.27, $98.48 and $98.40 to $98.23, $98.46 and $98.48 respectively, a net difference of fourteen cents. It is patently obvious, as the trial court noted (R. 1), that these were simply clerical errors relating to matters of form and not substance, and which in no way resulted in changing the theory of the government's case. *United States v. Krepper*, 159 F.2d 958, 970-972 (C.A. 3), certiorari denied 330 U.S. 824. Accordingly, the amendments were properly allowed.

Moreover, even if we assume *arguendo* that the amendments were improperly granted, it is fundamental that, since the sentence on the six counts of the indictment were ordered to run concurrently, and since the remaining three counts of the indictment are not attacked by appellant and are clearly valid, the conviction on these latter counts must be sustained. *Hirabayashi v. United States,* 320 U.S. 81, 85.

2. The trial court properly received into evidence Government Exhibit 1.

There is no merit to appellant's claim (BR. 3-4) that Government Exhibit One was improperly admitted into evidence. Briefly summarized, the testimony preceding the introduction of this exhibit into evidence — as related by government witness Jack Stevenson — is as follows: (R. 4-6)

In October of 1964, Stevenson had fallen down the stairway at the Lipman-Wolf Department Store in Portland. In connection with his insurance claim against this store for the accident, Stevenson was sent two checks, one payable to him and the hospital where he received medical attention, and the other (Govt. Ex. 1) payable to him and the Buck Ambulance Co. These were checks or drafts of the

Safeco-Lifeco General Insurance Company of America. Appellant was with Stevenson at the time he received these checks, and appellant asked Stevenson for one of these checks so he could make a duplicate to later use in his counterfeit operation. Stevenson turned over to appellant the check made out to the hospital, and retained the check made out to the Ambulance Company (Govt. Ex. 1) which he cashed. This latter check (Govt. Ex. 1) was substantially identical to the one turned over to and copied by appellant except for the name of the payee and the amount. Accordingly, this check was clearly admissible for the simple purpose of giving the jury some background concerning appellant's method of operation.

3. The evidence was sufficient to support the verdict.

Appellant does no more than raise an argument (BR. 4-5) that the trial court erred in not granting his motion for acquittal based on alleged insufficiency of proof. As shown in the statement of the case above, the evidence — viewed in the light most favorable to the government — overwhelmingly demonstrated appellant's guilt. Appellant initiated the counterfeiting scheme, printed the fictitious checks and identification documents, instructed his cohorts as

to when and where to cash the checks, and shared in the illicit proceeds. Appellant offered no testimony or any other evidence in defense, and the trial court was clearly correct in denying the motion for acquittal.

CONCLUSION

There was no prejudicial error in the proceedings below. The trial was fair and the evidence of guilt was overwhelming. It is respectfully submitted that the judgment of conviction should be affirmed.

SIDNEY I. LEZAK,
United States Attorney
District of Oregon

NORMAN SEPENUK,
Special Asst. United States Attorney

CERTIFICATE

I certify that in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that in my opinion, the foregoing brief is in full compliance with those rules.

Date: 3rd day of August, 1966.

NORMAN SEPENUK,
Special Asst. United States Attorney

No. 21088

In the

United States Court of Appeals

For the Ninth Circuit

ROBERT LEWIS BANZER,
Appellant,

v.

UNITED STATES OF AMERICA,
Appellee.

REPLY BRIEF OF APPELLANT

On Appeal from the United States District Court for the District of Oregon

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No. 21088

In the

United States Court of Appeals

For the Ninth Circuit

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UNITED STATES OF AMERICA,
Appellee.

REPLY BRIEF OF APPELLANT

On Appeal from the United States District Court
for the District of Oregon

COUNTER-ARGUMENT

We have considered the statement of the United States Attorney in Appellee's Brief, page 2, in which he quotes, "Appellant utilized the equipment to print a quantity of counterfeit blank checks of the Safeco Lifeco Insurance Company located in Seattle." (R. 11-12, 60-61).

In referring to these references, we note that many checks were allegedly printed besides the checks that were entered into evidence as referred to in Appellee's Brief (Transcript of Testimony, Page 11)

Q. "Did he print anything else, any other matter?

A. He printed some construction company checks and some Ford Motor Company checks, identification and driver's licenses."

(Transcript of Testimony, page 60)

Q. "Did you see him preparing these checks?

A. Yes.

Q. Would you please look at Government's Exhibit 2 through 7? I will ask if you can identify those.

A. I would say that these, in my opinion, are no checks that were being worked on. This one here looks a little different."

It, therefore, is reasonable to assume that the Grand Jury, in returning its Indictment under oath, described the offense presented to it based upon documents in it possession at that time.

QUESTIONS PRESENTED

The true inquiry, therefore, is not whether there is a variance in proof, but whether there has been such a variance as to "affect the substantive rights" of the accused.

The alterations in the Indictment by the Court and the United States Attorney amount to a substantive change, and would no longer be the Indictment of the Grand Jury which presented it.

It is the uniform ruling of the United States Courts, nd it is the imperative requirement of the provisions f the Constitution, (Amendment V), which would be f little avail if an Indictment once found can be hanged by the prosecuting officer with the consent of ne Court to conform to their views of the necessity of ne case.

We have no quarrel with (Krepper vs. United States) ted by the United States Attorney; in fact, the Krepper ase reaffirms the law as established in Ex Parte Bain.

Had the Government attempted to introduce into vidence the exhibits that were introduced (Exhibits 2 hrough 7) without the Amendment of the Indictment, hree of the exhibits would be objectionable as not being ne same instruments as described in the Indictment. his being so, the Amendment amounts to a "variance" as to affect the "substantive rights" of the accused.

The general rule that allegations and proof must orrespond is based on the objective requirements:

1) The accused shall be definitely informed as to ne charges against him so that he may be enabled to resent his defense and not be taken by surprise by the vidence offered at the trial; and

2) That he may be protected against another prosecution for the same offense.

Berger vs. United States, 259 U.S. 78, 83, 55 S. Ct
629, 79 L. Ed. 13, 14

We have carefully read the Citation in the Hirabayashi case 320 U.S. 81 at page 85, and find no application in the ruling of the Hirabayashi case that applie to the case at bar. Had the three defective indictment been eliminated, certain of the documents introduced in evidence would have been objectionable as being evidence of other crimes.

CONCLUSION

The substantive rights of the Appellant accused have have been grossly affected by the amendment of the Indictment requested by the United States Attorney and Ordered by the Court, and the cause should be reversed and remanded and the conviction set aside and vacated.

STANLEY J. MITCHELL

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CERTIFICATE OF ATTORNEY

I certify that, in connection with the preparation this brief, I have examined rules 18 and 19 of the nited States Court of Appeals for the 9th Circuit, and at, in my opinion, the foregoing brief is in full com- iance with those rules.

____

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NO. 21091

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

JOE TURNER,

Plaintiff and Appellant,

vs.

CHARLES H. LINDQUIST,

Defendant and Respondent.

APPELLANT'S OPENING BRIEF

APPEAL FROM
THE UNITED STATES DISTRICT COURT
FOR THE CENTRAL DISTRICT OF CALIFORNIA

FILED

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JOE TURNER,

Plaintiff and Appellant,

vs.

CHARLES H. LUNDQUIST,

Defendant and Respondent.

APPELLANT'S OPENING BRIEF

STATEMENT OF THE PLEADINGS AND FACTS

The Complaint

This action originally was brought by Plaintiff Joe Turner against Glen R. Roland. Subsequently Plaintiff filed an Amended Complaint joining Charles H. Lundquist as a party Defendant. In essence, Plaintiff's first cause of action alleges the following: (1) Both Defendants solicited Plaintiff to purchase debentures which were to be issued by United States Chemical Milling Corporation (hereafter USCM); (2) In connection with said solicitation Defendant Roland made a number of representations to Plaintiff with the knowledge, consent and assistance of Defendant Lundquist, including representations that USCM was in sound financial

condition and that certain financial statements of USCM which were shown to Plaintiff represented truly and fairly the condition of the business and affairs of USCM; (3) In reliance upon said representations Plaintiff purchased debentures from USCM for the sum of $100,000.00; (4) Said representations were false and Lundquist, who was President and a Director of USCM, and Roland, who was a Director and Secretary-Treasurer of USCM, knew or should have known the falsity of the representations; (5) USCM is insolvent and unable to pay the debenture; and (6) The United States Mails and Instrumentalities of Interstate Commerce were used by both Defendants and by USCM in the solicitation and consummation of the transaction.

The above facts were alleged to constitute a violation of Section 10(b) of the Securities Act of 1934, 15 U.S.C.A. §78(b), and Rule X-10B-5 of the Rules and Regulations of the Securities and Exchange Commission, 17 C.F.R. 240.10B-5. Jurisdiction was alleged to be based on Section 27 of the Securities Exchange Act of 1934, 15 U.S.C.A. §78AA.

A second cause of action incorporates by reference the allegations of the first cause of action; and alleges that the facts constituted a violation of 17(a) of the Securities Act of 1933, 15 U.S.C.A. §77q. Jurisdiction is based upon Section 22(a) of the Securities Act of 1933, 15 U.S.C.A. §77v.

A third cause of action incorporates the allegations of the first cause of action and states a common law claim for fraud and deceit, seeking compensatory damages of $100,000.00 and

$75,000.00 punitive damages (C. T. 2-8).

Federal Jurisdiction

With respect to the jurisdiction of the United States District Court over the first cause of action, Section 10b of the Securities Exchange Act of 1934 provides in pertinent part:

> "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility or any national securities exchange. . . .
>
> * * *
>
> "(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

Pursuant to this statutory authority, the Securities and Exchange Commission, in 1942, promulgated what is popularly known as "regulation X-10b-5", which provides as follows:

> "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

"(a) to employ any device, scheme, or artifice to defraud,

"(b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

"(c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security." 2CCH Federal Securities Rep. Par. 22, 725 (emphasis added).

Specifically, jurisdiction of the United States District Court over the first cause of action is based on Section 27 of the Securities Act of 1934, 15 U. S. C. A. Section 78aa which provides in pertinent part as follows:

"The District Courts of the United States . . . shall have exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder, and of all suits in equity and actions of law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder."

Jurisdiction of the United States District Court over the second cause of action is based on Section 17(a) of the Securities

Act of 1933, 15 U. S. C. A. Section 77q, which states in pertinent part:

> "(a) It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly --
>
> (1) to employ any device, scheme or artifice to defraud, or
>
> (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (3) to engage in any transaction, practice or course of business which operates or would operate as a fraud or deceit upon the purchaser."

Specifically, jurisdiction over the second cause of action is based upon Section 22(a) of the Securities Act of 1933, 15 U. S. C. A. Section 77v, which provides in pertinent part as follows:

> "The District Courts of the United States . . . shall have jurisdiction of offenses and violations under this sub-chapter and under the rules and regulations promulgated by the Commission in respect thereto, and

concurrent with State and Territorial Courts, of all suits in equity and actions at law to enforce any liability or duty created by this sub-chapter."

By reason of Rule 73(a) of the Federal Rules of Civil Procedure it would appear that an appeal from the judgment to the United States Court of Appeals is appropriate and that the within notice of appeal was timely filed.

STATEMENT OF THE CASE AND OF THE QUESTIONS INVOLVED

After Plaintiff's Complaint was amended so as to include Charles Lundquist as a party Defendant said Defendant moved the Court for an order disqualifying Plaintiff's then attorneys from further proceeding in the action on the ground that his attorneys had at one time represented USCM and had given legal advice to Defendant Lundquist. Extensive affidavits were filed by both sides and oral testimony was taken.

The Honorable Gus J. Solomon, District Court Judge assigned to the action, granted the motion to disqualify.

Present counsel for Plaintiff was substituted in place of the disqualified attorneys in March of 1965.

Defendant Lundquist's motion to disqualify Plaintiff's attorney, filed on August 7, 1964 was accompanied by a motion to dismiss, for more definite statement, and a motion for summary judgment (C. T. 243 etc.).

After present counsel for Plaintiff became substituted into the case, counsel for Defendant Lundquist brought to the Court's attention the fact that although the Court had ruled on Lundquist's motion to disqualify it had not ruled on his motions for summary judgment, dismissal, and for more definite statement.

Thereafter, and on June 9, 1965, the Honorable Gus J. Solomon denied the motion to dismiss, motion for summary judgment and motion for more definite statement, and in connection with said denial rendered a two-page memorandum opinion (C. T. 268-270).

The concluding paragraph of that opinion was as follows:

> "It may be that after a pre-trial order is filed, the facts admitted in such order will make the controversy ripe for decision on a motion for summary judgment. In that event, the Defendant LUNDQUIST will be given the opportunity to file such a motion."

Thereafter, Judge Solomon, due to the press of court business in his own district, relinquished the case and it was assigned to Honorable Harry Westover.

A pre-trial conference was ordered held, and in connection with that contemplated pre-trial conference Defendant Lundquist submitted a proposed pre-trial conference order (C. T. 271 etc.). The Court continued the pre-trial conference until March, 1966. Plaintiff had filed over thirty exhibits he had proposed to introduce into evidence (See C. T. 316-318).

On March 4, 1966 Defendant Lundquist renewed his motion for a summary judgment and for dismissal.

In opposition to the motion for summary judgment counsel for Plaintiff filed his own affidavit in opposition (C. T. 316 etc.). Summarized, that affidavit asserted that counsel for Plaintiff had examined many of the books and records of USCM and had attended a number of sessions of the bankruptcy proceedings of USCM and that as a result of counsel's investigation he acquired personal knowledge of a number of facts, which established that the financial statements presented to Plaintiff grossly misstated the assets of USCM as well as its income, in particulars set forth in the affidavit, and that Defendant Lundquist and his family had sold USCM stock in 1960, receiving nearly $1,000,000.00.

The affidavit concluded with a statement that none of the facts asserted in the affidavit were disclosed to Plaintiff when he made his loan to USCM and that most of the facts were discovered by Plaintiff in 1965 through counsel's investigation. (The affidavit is attached as Exhibit 1 to this brief.)

The Court granted the motion for summary judgment and for dismissal (C. T. 327).

The Court should note that this is an action for fraud. Present counsel for Plaintiff took three depositions, spent over 200 hours going through voluminous records of USCM in the custody of the trustee in bankruptcy, interviewed numerous persons, read several transcripts of proceedings conducted in connection with the USCM bankruptcy, and spent approximately one week in the court

of Referee James Moriarty, listening to testimony concerning the affairs of USCM, consulted with counsel for Defendant Lundquist in the preparation of a 38-page pre-trial statement, and prepared and filed numerous contentions of fact. These contentions embodied the conclusions counsel for Plaintiff reached on the basis of the above investigation, and are conclusions based on an analysis of original, authenticated records (See C. T. 341-346 for contentions of fact).

Counsel's investigation, as reflected in Plaintiff's contentions of fact, disclosed that during the very month that Plaintiff was induced to agree to loan USCM his money, Defendant Lundquist sold 7, 760 shares of USCM stock for a total gross price in excess of $80, 000. 00. In addition, in June of 1960, approximately 5 months prior to Plaintiff's agreeing to loan USCM his money, Lundquist sold 9, 600 shares of USCM stock for a total gross sales price of $261, 600. 00. Sales of Lundquist's relatives were not included in those figures. Lundquist did not reveal these facts to Plaintiff.

Plaintiff was only one of a number of persons who loaned USCM substantial sums in January of 1961. Of the total loaned, $325, 000. 00, was used to repay loans made to USCM by various Directors, officers and relatives of Directors and officers of USCM. These facts were not revealed to Plaintiff.

Defendant Lundquist had represented to Plaintiff that the vending division of USCM was profitable, neglecting to disclose to Plaintiff that in fact it was losing large sums of money, that

management had concluded that the existing vending machines of USCM were not marketable and that a sale of the division was being seriously considered.

The vending machine situation was so bad that the machines as well as the rights of USCM under leases and sales contracts for the machines, all of which were substantially delinquent, were transferred to another corporation in return for a note for $569,000.00. The corporation which purchased all those machines and lease and sale contracts had practically no assets at the time of the transaction and was controlled by the Directors of USCM. At the time of the transaction the Directors of USCM put their shares of the other corporation in the names of dummies so that an investigation would not reveal that a majority of the shares of the transferee corporation were owned by the officers and Directors of USCM. All of this was brought out in the bankruptcy proceedings before Referee Moriarty and were matters of public record in 1965.

The effect of the transaction was that USCM carried on its books a note of $569,000.00. If President Lundquist had not engineered the transaction, there would have been substantial write-offs by the corporation's accountants based on the unmarketability of the vending machines and the delinquencies in payments by the various vendees and lessess. Ultimately these machines were repossessed or disappeared.

In addition, the financial statement presented to Plaintiff indicated a termination claim against Boeing Airplane Company of $395,551.00, carried in the full amount thereof. Lundquist

neglected to disclose to Plaintiff that the claim was not based on any written contract, and that Boeing had denied liability. Shortly after Plaintiff made his loan to USCM the amount of that asset was substantially written down and ultimately the claim was settled for $100, 000. 00.

The consolidated financial statement presented to Plaintiff showed that for the previous fiscal year USCM had earned a profit of nearly $1, 000, 000. 00. In fact it suffered a loss that year, which it concealed by means of such devices as above described.

In the proceedings before the Referee in bankruptcy the trustee claimed that substantial sums were paid by USCM to its profit sharing plan based on the profit reflected in the financial statement shown to Turner, and that in fact profits for the year were slight if any. The Referee in bankruptcy has ruled that the financial statement which served as a basis for the contribution to the employees' profit sharing fund (the same financial statement shown to Plaintiff) vastly misstated the results of operations for that fiscal year.

Why Defendant Lundquist, who was President of USCM, engineered this deception cannot be known for sure. Had the true facts concerning the financial health of the corporation been disclosed to the debenture purchasers such as Plaintiff, and to the public at large, no one would have bought the debentures and presumably the USCM stock would have fallen much faster than in fact it did fall in 1960 and Lundquist would not have been able to realize the hundreds of thousands of dollars of profit that he made when he

sold his stock in USCM.

Counsel for Plaintiff has recited above only some of the deceptions practiced by Lundquist. And although, at least for purposes of this appeal, the above statements are my own assertions, the fact remains that in the bankruptcy proceedings the Referee has announced that there was a gross falsification of USCM's financial position in its financial reports. And although Defendant Lundquist was not technically a defendant in the bankruptcy proceedings before Referee Moriarty, the fact remains that he had a sufficient interest to be in attendance almost every day of the hearings and that Robert Driscoll, counsel for Defendant Lundquist in this action, was counsel in the bankruptcy proceedings. Hence, USCM was found to have distributed grossly misleading financial statements in a proceeding in which for all practical purposes Defendant was the real party in interest.

Thus in analyzing this case this Court should at least be aware of the fact that Defendant Charles Lundquist is guilty of the grossest kind of fraudulent deception and that this was found to be the case by a Referee of the United States District Court for the Southern District of California.

Justice demands that Plaintiff be given an opportunity to prove the fraud and compel Lundquist to disgorge some of the profits he has made by his manipulations.

SPECIFICATION OF ERRORS

1. The motion to dismiss should have been denied because the first amended Complaint was not defective.

2. The motion to dismiss should have been denied even if the first amended Complaint was defective, in order to give Plaintiff an opportunity to remove any technical defect by amendment.

3. The motion to dismiss should have been denied because said motion previously had been made to Judge Solomon and had been denied by him, and this became the law of the case as to any coordinate judge.

4. The motion for summary judgment should have been denied because a previous motion based on facts of the same legal significance had been denied by Judge Solomon, and such denial was the law of the case as to any coordinate judge.

5. Before ruling on the motion for summary judgment the Court should have granted Plaintiff's counsel's request for leave to file an additional affidavit in the event that the existing affidavits on file were insufficient to raise a genuine issue of fact.

ARGUMENT

I

THE MOTION TO DISMISS SHOULD HAVE BEEN DENIED BECAUSE THE AMENDED COMPLAINT WAS NOT DEFECTIVE.

To this day Appellant's counsel is not sure exactly why the trial Court granted Defendant Lundquist's Motion to Dismiss. The trial Court, in granting the Motion to Dismiss and the Motion for Summary Judgment, did not file a Memorandum of Opinion which might have indicated the basis for its decision. There were, however, remarks made by the Court and counsel at the time of hearing on Defendant Lundquist's Motion to Dismiss and Motion for Summary Judgment, which remarks are transcribed in Volume 2 of the Clerk's Transcript. Appellant's counsel can only assume that the reasons for the Trial Court's action may be inferred from the Trial Court's statements at the time of oral argument.

The Trial Court remarked (C. T. 4-5) as follows:

"I went over these files the other day and it seems to me that the motion must be granted. I will tell you why . . . then you say in paragraph VI: 'Defendants and each of them solicited Plaintiff to purchase - -' now, that's fine, but in Paragraph VII you say: 'In so soliciting Plaintiff to purchase, Defendant Roland made the following representations.' Now, you don't say that Lundquist did anything at all. All you allege is that Lundquist was a member of the

board of directors and that he was president. Now how can you maintain an action with that sort of an allegation?"

However, page 3 of the first Amended Complaint (C. T. 4) states in part as follows:

"In so soliciting Plaintiff to purchase said debentures, Defendant Roland made the following representations, among others, to Plaintiff with the knowledge, consent and assistance of Defendant Lundquist. . . ."

Further, on page 2 of the first Amended Complaint, Plaintiff alleged that "Defendants, and each of them, solicited Plaintiff to purchase. . .".

In view of the above allegations, we submit that the agency relationship between Defendants Lundquist and Roland, both of whom were officers and directors of the corporation, was sufficiently alleged so as to make the representations of Defendant Roland binding upon Defendant Lundquist.

II

THE MOTION TO DISMISS SHOULD HAVE BEEN DENIED EVEN IF THE FIRST A-MENDED COMPLAINT WAS DEFECTIVE, IN ORDER TO GIVE PLAINTIFF AN OPPORTUNITY TO REMOVE ANY TECHNICAL DEFECT BY AMENDMENT.

Plaintiff's contentions of fact filed with the trial court before the hearing on the Motions to Dismiss and for Summary Judgment contained numerous allegations of conduct by Defendant Lundquist and numerous allegations concerning the financial condition of USCM, which Defendants concealed from Plaintiff. Said contentions of fact also recited numerous representations that were set forth in Plaintiff's contentions as being representations of Defendants. The contention that Defendants concealed numerous facts from Plaintiff and that Defendants made numerous affirmative misrepresentations are set forth in detail at pages 341-346 of the Clerk's Transcript.

Hence, even if the first Amended Complaint did not sufficiently allege Defendant Lundquist's participation in the representations, the contentions of Plaintiff on file with the trial court gave notice to all concerned that Plaintiff was contending that the misrepresentations were by Defendant Lundquist as well as Roland.

Further, aside from the above, the exhibits lodged with the court before oral argument on Defendant's motions included numerous documents signed by Defendant Lundquist and admitted by Defendant Lundquist in the pretrial statement to have been

executed by him. See, for example, references in the pretrial statement (C. T. 284-285) to Plaintiff's Exhibit 1, which was a copy of an agreement between USCM and certain lenders, including Plaintiff. The pretrial statement admitted that Defendant Lundquist executed said agreement on behalf of USCM and that Plaintiff also executed the agreement. This agreement was the agreement pursuant to which Appellant purchased the debenture from USCM. The agreement contained the following representation:

> "The financial statements, including the balance sheet and income statement as at and to September 30, 1960, and all notes thereto, which were heretofore delivered to you, present fairly the consolidated financial condition of the company and its subsidiaries at September 30, 1960, and the results of operations of such corporations for the periods specified therein. . . ."

Exhibit 3 lodged with the court, referred to in the pretrial statement (C. T. 284) was a copy of a letter to Plaintiff from USCM signed by Defendant Lundquist as president of USCM and on behalf of USCM. Exhibit 5 was a copy of the USCM annual report for the fiscal year ended January 31, 1960. It was admitted in the pretrial statement that Plaintiff received said annual report in December 1960 at the same time he received a copy of Exhibit 3. Said financial statement purported to show a profit for USCM and its subsidiaries of approximately one million dollars for the preceding

year.

In a nutshell, the significance of the above Exhibits is as follows: Defendant Lundquist, on behalf of USCM, made a representation to Appellant in Exhibit 1 lodged with the trial court that the financial statements dated January 31, 1960 and September 30, 1960 fairly represented the financial situation of USCM as and for the periods covered in those respective statements. A large part of Appellant's case is that in fact they did not fairly represent the financial situation of USCM. All of this was made known to the trial court on oral argument on Defendant's motions.

In this connection, counsel for Appellant argued to the trial court as follows:

> "Furthermore, I could be in error, but I believe that the Complaint alleges an agency relationship between Roland and Lundquist, so that the representation of Roland would be a representation of Lundquist. . . . But more than that, your Honor, you have representations in the financial statements of USCM which are signed by Defendant Lundquist, representations and the agreement pursuant to which Mr. Turner purchased stocks; representations that the financial statements submitted to Mr. Turner accurately represented the financial condition of the company. . . . However, it seems to me that any defect that may have existed, and I am not conceding that it did exist in the Complaint, has been cured by the allegations of

the Plaintiff in the pretrial statement. We have gone this far and I would hate to think that on the eve of trial the Plaintiff is going to be thrown out of Court because perhaps technically he may have not alleged specifically that Defendant Lundquist made any representations. I would be prepared to amend the Complaint accordingly and set forth the representations that were made by the Defendant Lundquist. . . . If the Court is correct that there is a defect and if this defect has not been cured by the pretrial statement, then I submit that I should have an opportunity to cure that defect which, as far as I am concerned is purely technical, because we have got the facts, we have alleged them in an affidavit and alleged them in the pretrial statement and we can allege them in the Complaint if necessary." (C. T. V. 2, 6-7).

Hence it must be conceded that Appellant contended throughout the proceedings that Defendant Lundquist as well as Roland made misrepresentations and that the fact that Defendant Lundquist did make representations was proved by Plaintiff's pretrial Exhibits and conceded by Defendant Lundquist in the pretrial statement. All of this was brought to the attention of the trial court, and if there was any technical defect in Plaintiff's first Amended Complaint, he could have amended it to cure any technical defects. And as shown on page 7 of Volume 2 of the Clerk's Transcript, Plaintiff's counsel

requested the opportunity to file an amended Complaint if the Court felt that the existing Complaint was defective in its statement of a claim against Defendant Lundquist.

If the Court felt that the first Amended Complaint was defective, it was error for the Court to grant Defendant Lundquist's Motion to Dismiss without first giving Plaintiff an opportunity to cure the defect by amendment. An analysis of the above subject is contained in Barron and Holtzoff, Federal Practice in Procedure, Volume IA, Section 356 as follows:

> "The motion to dismiss for failure to state a claim on which relief can be granted is viewed with disfavor in Federal Courts because of the possible waste of time in case of reversal of a dismissal of the action, and because the primary objective of the law is to obtain a determination of the merits of the claim. . . . The United States Supreme Court has endorsed the accepted rule that a complaint should not be dismissed for failure to state a claim unless it appears beyond doubt that the Plaintiff can prove no set of facts in support of his claim which would entitle him to relief. . . the test is whether in the light most favorable to Plaintiff, and with every intendment regarded in his favor, the Complaint is sufficient to constitute any valid claim."

In United States v. Thurston County Nebraska, 54 F. Supp. 201 (affirmed at 149 F. 2d 485 - 8th Circuit), the court stated:

"The rule is that it (motion to dismiss), should be denied, though the complaint be infirm, if it is reasonably conceivable that at the trial upon the merits the Plaintiff might establish a cause of action (citations)." (Matter in parenthesis supplied).

And in John Walker and Sons v. Tampa Cigar Co., 197 F.2d 72, 73 (5th Circuit), the Court stated:

"It is also elementary that a complaint is not subject to dismissal unless it appears to a certainty that the Plaintiff cannot possibly be entitled to relief under any set of facts which could be proved in support of its allegations. Even then, a Court ordinarily should not dismiss the Complaint except after affording every opportunity to the Plaintiff to state a claim upon which relief might be granted."

The above case was quoted with approval in reversing a dismissal in Black v. First National Bank of Mobile, Alabama, 255 F.2d 373 (5th Circuit).

In Nagler v. Admiral Corporation, 248 F.2d 319 (2nd Circuit), the trial court had dismissed for improper pleading. The appellate court stated:

"The drastic remedy here granted for pleading errors is unusual, since outright dismissal for reasons not going to the merits is viewed with disfavor in the

federal courts. . . .

"Courts naturally shrink from the injustice of denying legal rights to a litigant for the mistakes in technical form of his attorney . . . . We are clear, therefore, that the case must go back for some less final disposition at least permitting plaintiffs to amend."

III

BOTH THE MOTION TO DISMISS AND THE MOTION FOR SUMMARY JUDGMENT SHOULD HAVE BEEN DENIED BECAUSE A PREVIOUS MOTION BASED ON FACTS OF THE SAME LEGAL SIGNIFICANCE HAD BEEN DENIED BY ANOTHER COORDINATE JUDGE.

As mentioned above, Defendant Lundquist's original Motion to Dismiss and Motion for Summary Judgment were denied by Chief Judge Solomon of Oregon, while on assignment to the United States District Court of the Southern District of California. Judge Solomon had previously disqualified Plaintiff's original counsel from further proceeding in the action, after a lengthy hearing involving oral testimony, extensive affidavits and legal memoranda. Hence Judge Solomon was intimately familiar with the case when he denied Lundquist's Motions to Dismiss and for Summary Judgment, Judge Solomon previously having handled numerous matters related to the case, extending over a period of many, many months. However, Judge Westover, newly assigned to the case and not previously having decided any matter of substance concerning the case, granted

Defendant Lundquist's Motions when renewed by said Defendant.

As far as Appellant can determine, anything favorable to Lundquist's Motions which was presented to Judge Westover had previously been presented to Judge Solomon.

In Commercial Union of South America Inc. v. Anglo-South American Bank, 10 F. 2d 937, one Judge of the District Court had denied a Motion to Dismiss the Complaint on the ground of insufficiency. A second judge granted the Motion when later renewed. The Court of Appeals reversed, holding that regardless of the propriety of the first judge's denial of the Motion, the ruling was the law of the case and should not have been changed by another judge. In the words of the Court:

> ". . . the decision made by Judge Mack was the law of the case as established in the District Court, and should have been so treated by any other judge sitting in the same case in that Court. Judges of co-ordinate jurisdiction, sitting in the same Court and in the same case, should not overrule the decisions of each other."

Hence aside from the propriety of Chief Judge Solomon's denial of Lundquist's Motions for Dismissal and for Summary Judgment, it was not for another United States District Court Judge to in effect overrule the previous ruling of Chief Judge Solomon.

Appellant recognizes that if Lundquist had presented legally significant additional facts to Judge Westover, which had not previously been presented to Judge Solomon, that conceivably Judge

Westover could have ruled differently from Judge Solomon. However, the fact is that in this case no legally significant facts were presented to Judge Westover that had not previously been presented to Judge Solomon. Therefore, the principle that the ruling of one judge shall not be overruled by a judge of a co-ordinate court should apply in this case.

IV

REGARDLESS OF ANY PREVIOUS RULING BY A CO-ORDINATE JUDGE, THERE WAS A TRIABLE ISSUE OF FACT ON THE STATUTE OF LIMITATIONS, AND SUMMARY JUDGMENT SHOULD NOT HAVE BEEN GRANTED.

During oral argument to the trial court, appellant's attorney stated (C. T. V.. 2, 13-14):

> "There was a Motion by Defendant Lundquist for Dismissal of the Complaint for Summary Judgment, for More Definite Statement, and all of these Motions were denied by Judge Solomon in a Memorandum Opinion which I have attached as an Exhibit to my own Memorandum. So I thought that point was put to rest."

Appellant's counsel went on to state (C. T. V. 2, 21-22):

> "I submit, your Honor, that when the Plaintiff discovered or should have discovered the facts constituting the fraud is a question of fact and should not be resolved on a Motion for Summary Judgment, and I am

representing to the Court that if the Court feels that the affidavits presented by the Plaintiff thus far are deficient, that I am prepared to supply additional affidavits by myself and by my client, further indicating the dates upon which he discovered specific misrepresentations. . . . If the Court feels that the affidavits are deficient in this respect, I am prepared to submit additional affidavits by myself and Mr. Turner nailing down with even greater detail the specific times when the various misrepresentations and concealments were discovered, your Honor."

This writer believes that first, Defendant Lundquist's Motions should have been denied because already previously denied by another judge of the same court; secondly, that the Affidavit of myself (C. T. 316 etc.) and the Affidavit of Robert A. Smith, original counsel for Plaintiff (C. T. 87 etc.) clearly demonstrated that when the Statute of Limitations against Plaintiff began to run was a triable question of fact; thirdly, in view of the prior ruling and in view of the affidavits submitted by Plaintiff, if the judge newly assigned to the case felt that additional affidavits would be necessary to establish a triable issue of fact, Plaintiff's counsel should have been given an opportunity to file such additional affidavits. And, as shown by the record, Plaintiff's counsel at the time of oral argument stated that he would file additional affidavits if the Court felt that the existing ones were insufficient.

The general principles with respect to the granting of Motions for Summary Judgment are set forth in Moore's Federal Practice, Volume 6, pages 2853-54 as follows:

> "The party moving for Summary Judgment has the burden of establishing by a record that is adequate for decision of the legal question presented that there is no triable issue of a material fact; and he has the burden even as to issues upon which the opposing party would have the trial burden. And the moving party's papers are carefully scrutinized, while the opposing party's papers, if any, are treated with considerable indulgence. If the moving party fails to shoulder his burden his motion should be denied, even though the opposing party has presented no evidentiary materials in opposition, and has not presented any 56 (F) affidavit."

Hence we submit that even in the absence of any affidavits by Plaintiff or his counsel, the Motion for Summary Judgment should have been denied because the moving party presented no evidence as to when Plaintiff discovered or should have discovered the facts constituting the fraud.

Barron and Holtzoff, Volume 3, states as follows (p. 132):

> "A movant is not entitled to Summary Judgment unless the facts established show a right to judgment with such clarity as to leave no room for controversy

and show affirmatively that the adverse party cannot prevail under any circumstances (numerous citations)."

Pages 135-136:

"Summary Judgment must be denied if the evidence is such that conflicting inferences could be drawn therefrom or if reasonable men might reach different conclusions (numerous citations)."

Pages 138-140:

"One who moves for Summary Judgment has the burden of demonstrating clearly that there is no genuine issue of fact. Any doubt as to the existence of such an issue is resolved against him. The evidence presented at the hearing is liberally construed in favor of the party opposing the Motion and he is given the benefit of all favorable inferences which might reasonably be drawn from the evidence (numerous citations)."

Pages 175-176:

"Summary Judgment is a drastic remedy, and the Courts properly have been liberal in exercising their discretion under Rule 56 (F) and giving the party opposing the motion full opportunity to show any genuine issue which may exist, even where the party could have made that showing at the time the motion came on for hearing."

In <u>Tracer Lab., Inc. v. Industrial Mucleonics Corporation,</u>

313 F. 2d 97 (1st Cir.), there was a suit for misappropriation of trade secrets. The applicable state's Statute of Limitations was two years, excluding the time during which a person liable fraudulently conceals a Cause of Action from the knowledge of the person entitled to bring the action. The Court of Appeals held that there was a genuine issue of material fact as to when Plaintiff had the requisite knowledge (page 102 of the opinion) and "consequently we believe that the District Judge erred in holding that the suit was barred by the Statute of Limitations".

In Dictograph Products Co., Inc. v. Sonotone Corp., U. S. D. C., S. D. New York (1951), 95 F. Supp. 126, Plaintiff alleged fraud. Defendant moved for Summary Judgment on the ground of laches. Motion was denied because "It cannot be determined with assurance on the present record that the Plaintiff had or was chargeable with such knowledge of the fraud . . .".

In Gonzales v. Tuttman, U. S. D. C., S. D. New York (1945), 59 F. Supp. 858, Defendant moved for Summary Judgment on the ground of the Statute of Limitations. The fourth cause of action was based on an alleged violation of Puerto Rican Law. The Puerto Rican Statute of Limitations required the action to be brought within three years after the discovery by the aggrieved party of the facts upon which the penalty or forfeiture attached or the liability was created. The Court held:

> "The burden of establishing that no material issue of fact is present on the Motion for Summary Judgment rests on the moving party. . . . Every

doubt should be resolved against the moving party. . . . The moving party has failed to sustain its burden and hence a material issue of fact being present, the Court must deny the Motion for Summary Judgment as to the first and the third causes of action."

As to the Puerto Rican Cause of Action, the Court stated:

"The moving papers present an issue of fact as to just when the facts creating a liability were discovered and hence even assuming the Puerto Ricans Statute applies, which the Court does not decide, there is an issue of fact which necessitates a denial of the motion as to this cause of action."

And as to any alleged technical deficiency in the affidavits, the Court should note the following cases:

In Corley v. Life and Casualty Insurance Company of Tennessee, 296 F. 2d 449 (1961), the Court of Appeals reversed a Trial Court Summary Judgment on the grounds that Rule 56(e),

" . . . does not require an unequivocal ruling that the evidence suggested in this particular affidavit would be admissible at the trial as a condition precedent to holding the affidavit raises a genuine issue."

The Court concluded:

"It is therefore possible and perhaps probable, that Lockhart's alleged admission out of Court will be

admissible . . . . This is sufficient to defeat the Motion for Summary Judgment because the Courts are inclined to hold the movant to a strict demonstration that no genuine issue exists."

And in United States v. Western Electric Co., 337 F.2d 568 (9th Cir. 1964), the Court of Appeals reversed a Summary Judgment. The affidavit in opposition was technically deficient because made under penalty of perjury and not under oath. The Court said that if the appellee's had objected to use of the Declaration, "the defect could have been remedied by appellants filing an affidavit in lieu of the declaration".

This Circuit concluded:

> "Moreover, while Rule 56 (e) does not state any different requirement for opposing affidavits than for the movant's affidavits, 'the paper supporting the movant are more clearly scrutinized whereas the opponent's are indulgently treated'."

CONCLUSION

Even after Plaintiff's counsel argued extensively to the Trial Court with reference to the Agency allegations of the Complaint, and with reference to the Contentions set forth in the pretrial statement and the Exhibits lodged with the Court showing that the representations relied on by Plaintiff were made by Defendant

Lundquist, the Trial Court still stated at page 26 of Volume 2 of the Clerk's Transcript as follows:

> "That you don't allege any place, as far as I know, that LUNDQUIST ever made a misrepresentation to your client."

This writer of course disagrees with the Trial Court's above statement since the amended Complaint did allege that the representations made by Roland were made with the knowledge, consent and assistance of Defendant Lundquist, and since the Complaint further alleged that Defendant solicited Plaintiff. However, even if the Trial Court were correct in its above statement, the record before the Trial Court, including the pretrial statement, Plaintiff's Contentions of Fact and the Exhibits on file, all showed that Lundquist, in writing, represented to Plaintiff what the financial condition of USCM was as set forth in the financial statements shown to Plaintiff. If this was not sufficiently set forth in the Complaint, the Trial Court should have deemed the pretrial statement to have superseded the Complaint in that respect and to have cured that defect. Otherwise, the Trial Court should have permitted Plaintiff's counsel to amend the Complaint to cure the defect, if any, as requested by counsel during oral argument.

This writer still cannot believe that after a case has been pending for several years, after discovery has been completed, after a detailed pretrial statement and Plaintiff's Contentions have been filed, and after 39 proposed Exhibits are filed by Plaintiff,

and approximately one month before the date set for trial, that the Trial Court would dismiss the action on the basis of a defect which does not exist, and which if it did exist was purely technical.

On page 20 of Volume 2 of the Clerk's Transcript, the following statement was made by the Trial Court:

> "Well, now if Mr. LUNDQUIST made these misrepresentations, then you should have discovered he made the misrepresentations as soon as Mr. ROLAND made the misrepresentations. You say they did it jointly. Why couldn't you just discover that if ROLAND made a misrepresentation, then LUNDQUIST made a misrepresentation. You said they did it jointly."

While it is difficult to speculate as to exactly what the Court had in the back of its mind on the basis of the above quoted statement, it appears to this writer that what was bothering the Court was that Defendant Lundquist was not made a party Defendant originally, and that he was brought into the action as a party defendant by means of an amended Complaint. The Trial Court's apparent distaste for Plaintiff not making Lundquist a party Defendant when the action was originally filed, it seems to this writer, might have been relevant when Plaintiff requested permission to file an amended Complaint naming Lundquist as a Defendant. Judge Solomon permitted an amended Complaint to be filed naming Lundquist as a Defendant. It would appear to this writer that Judge Westover might have refused Plaintiff permission to file an amended

Complaint naming Defendant Lundquist as a party to the action and that it is this apparent attitude of Judge Westover with the respect to the propriety of filing an amended Complaint adding Lundquist as a Defendant, which has caused Judge Westover to grant the motions made by Defendant Lundquist. We submit that how Judge Westover might have ruled on Plaintiff's Motion to File an Amended Complaint naming Lundquist as an additional Defendant had the Motion been heard by Judge Westover, is no proper basis for Judge Westover to grant Defendant Lundquist's Motions to Dismiss and for Summary Judgment.

This writer respectfully urges this Court to give careful consideration to Volume 2 of the Clerk's Transcript, which sets forth in 31 pages what transpired at the hearing on Lundquist's Motions before Judge Westover.

Lundquist was made a Defendant in May of 1964. Almost two years thereafter, and less than one month before the scheduled trial date, Plaintiff is thrown out of Court, after literally hundreds of hours of work and preparation for trial. All the Appellant requests is his opportunity to have his day in Court. All he wants is the opportunity to present the facts showing the fraud and the circumstances which caused him to learn of the fraud. Then, after Plaintiff has had his day in Court, it will be proper for the trier of fact to determine 1) whether there was fraud; and 2) whether Plaintiff discovered or should have discovered the facts constituting the fraud more than 3 years before Defendant Lundquist was made a party Defendant. We are prepared to accept an adverse finding

on both whether there was fraud and on whether the Statute of Limitations had run before Lundquist was made a party Defendant. What we object to, however, is the Court making findings on these issues before Plaintiff has had a fair opportunity to present his case.

Appellant asks this Court to give him the opportunity to have this day in Court.

Attached as an appendix to this brief and incorporated hereat is a legal analysis showing that the applicable Statute of Limitations is three years from when the fraud was discovered or should have been discovered. The analysis is virtually the same as that presented to Judge Solomon prior to that Judge's denial of Defendant Lundquist's Motions to Dismiss and for Summary Judgment.

Respectfully submitted,

RICHARD H. LEVIN

Attorney for Plaintiff and Appellant.

CERTIFICATE

I certify that in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

/s/ Richard H. Levin
RICHARD H. LEVIN

EXHIBIT I

I, RICHARD H. LEVIN, declare as follows: I am attorney of record for Plaintiff in this action. Since becoming attorney of record for Plaintiff I have personally examined many of the books and records of United States Chemical Milling Corporation in the custody of the trustee in Bankruptcy and the Referee in Bankruptcy. I have also attended a number of Sessions of the bankruptcy proceedings before Referee Moriarty, where it is claimed that the USCM annual report for the fiscal year ended January 31, 1960 falsely claimed that USCM made a substantial profit that year whereas in fact it had sustained a substantial loss.

As a result of the above investigation I have acquired personal knowledge of the following facts:

1. Defendant LUNDQUIST and other USCM directors owned and controlled the Unimerc Corporation at a time when they caused Unimerc to purchase almost worthless conditional sales contracts held by USCM in exchange for a Unimerc note for $569, 662. 63. At that time Unimerc had practically no assets. This permitted USCM to carry the Unimerc note on USCM's books at face value, thus avoiding a $400, 000. 00 writedown on the value of the conditional sales contracts for the fiscal year ended January 31, 1960.

2. In January of 1960 Darco Industries, a wholly owned subsidiary of USCM, sold certain machinery to Unimerc Corporation for $208, 000. 00, for which USCM received a note in that

amount from Unimerc. Darco or USCM immediately leased the property back from Unimerc, and Darco took a $91,250.00 gain on the sale. This was a mere paper transaction between related corporations, which permitted USCM to show a $91,250.00 gain for the fiscal year ended January 31, 1960.

3. In 1960 Defendant LUNDQUIST and his family sold USCM stock receiving nearly one million dollars for said stock.

4. The money Plaintiff loaned USCM was to be used to pay Defendant LUNDQUIST, his family and Mr. Driscoll's law partner CLAYTON HURLEY amounts owing them for loans to USCM.

5. The annual report for the fiscal year ended January 31, 1960 carried as an asset in the full amount thereof a termination claim of $395,551.00 against Boeing Airplane Co.. There was no written contract between USCM and Boeing, and Boeing had denied liability on the claim.

6. In February of 1960 USCM transfered 573 Barvend vending machines to Unimerc Corporation in return for a note for $372,450.00. The machines were unmarketable, and the effect of the transfer was to permit USCM to carry a brand new note for $372,450.00 as an asset in lieu of these unmarketable machines. The results of these dummy transactions and grossly overstated assets was to permit USCM to present to Plaintiff a materially misleading picture of its financial position to induce him to make his loan to USCM.

None of these facts were disclosed to Plaintiff when he made his loan to USCM, and most of these facts were discovered

by Plaintiff in 1965 through my investigation, as a result of attending sessions of the USCM bankruptcy proceedings still pending before Referee Moriarty.

Mr. Turner is outside the County of Los Angeles at this time.

/s/ Richard H. Levin
RICHARD H. LEVIN

Subscribed and sworn to before me
March 9, 1966.

Marian Y. Anderson
My Commission Expires Feb. 24, 1967

(SEAL)

/s/ Marian Y. Anderson

APPENDIX

THE COMPLAINT IS NOT SUBJECT TO A MOTION TO DISMISS BASED UPON THE STATUTE OF LIMITATIONS.

1. The First Cause of Action.

a. There is no federal statute of limitations applicable to actions under 10(b) of the Securities Exchange Act of 1934 (15 U. S. C. §78j).

Unlike section 12 of the Securities Act of 1933 (15 U. S. C. §77) which is governed by a one year statute of limitations as set forth in section 13 of the same act (15 U. S. C. §77m), section 10(b) of the Securities Exchange Act of 1934 (15 U. S. C. §78j) does not have its own statute of limitations. Professor Loss discusses this question as follows:

> "What statute of limitations governs when, as in the case of Rule 10b-5, none is provided in the act? Section 29(b) was amended in 1938, as part of the Maloney Act amendments to §15(c) by the insertion of a statute of limitations with reference to actions under §29(b) based on alleged violation of a rule adopted under 15(c)(1). But there is no reference to §10(b) in any other section, and there is no federal statute of limitations for civil actions generally." III LOSS, SECURITIES REGULATIONS 1771 (2d ed. 1961).

It has been argued that since the Securities Act of 1933

provides comprehensive remedies for buyers, any buyer bringing an action under the more general section 10(b) of the Exchange Act of 1934 should have to meet the same one year statute of limitations applicable to buyer actions under section 13 of the 1933 Act (15 U.S.C. 77m). Section 13 reads as follows:

> "No action shall be maintained to enforce any liability created under section 77k or 771(2) of this title unless brought within one year after the discovery of the untrue statement or the omission, or after such discovery should have been made by the exercise of reasonable diligence, or, if the action is to enforce a liability created under section 771(1) of this title, unless brought within one year after the violation upon which it is based. In no event shall any such action be brought to enforce a liability created under section 77k or 771(1) of this title more than three years after the security was bona fide offered to the public, or under section 771(2) of this title more than three years after the sale...."

The contention that this section should be applied to actions brought by buyers under section 10(b) was expressly rejected in the case of Premier Industries, Inc. v. Delaware Valley Financial Corp., 185 F. Supp. 694 (E.D. Pa., 1960):

> "Moreover section 77m (section 13 of the Securities Act) expressly refers to liability under

"section 77k and section 771(2) [sections 11 and 12(2) of the Securities Act respectively], and for this court to extend its application to other sections of either act by judicial interpretation would be an affront to the legislative process. Finally, aside from all that has been said, there are such cases as Osborne v. Mallory, 86 F. Supp. 869 (S. D. N. Y., 1949); Tobacco and Allied Stocks v. Transamerica Corp., 142 F. Supp. 323 (D. Del., 1956), and other cited cases therein, which have expressly held that the statute of limitations applicable to actions under section 77q [Section 17 of the Securities Act] or Section 78j [Section 10b of the Exchange Act] of title 15 U. S. C. A. is the applicable state statute of limitations."

Id., 666.

The same result was reached by the Ninth Circuit of Appeals in Ellis v. Carter, 291 F. 2d 270 (1961). The court in that case considered four alternative methods of handling buyer actions brought under section 10(b) of the 1934 act and finally adopted the method which freed such actions of, among other things, the one year statute of limitations contained in section 13 of the 1933 act:

"... we consider it [the alternative adopted by the court] the most acceptable of the four possible alternatives. It gives controlling

weight to what seems to have been the dominant policy of Congress to provide complete and effective sanctions, public and private, with respect to the duties and obligations imposed under the two acts. It requires no variance in proceedings under the 1934 act as between buyer and seller, no reason appearing why Congress would have wanted the procedures to be different. While it assumes that Congress in 1934 undid what it carefully did in 1933, it avoids judicial rewriting of the 1934 act to include procedural provisions which appear only in the 1933 act. As between the two acts which deal with the problem, it permits the most recent enactment to govern." Id., 274.

b. Actions brought under Section 10(b) are controlled by the applicable state statute of limitations governing actions based on fraud or deceit--in this case the three year limitation provided in §338 of the California Code of Civil Procedure.

As noted in the Premier Industries case, supra, it has been held with regularity that when claims for relief of a legal nature are asserted under section 10(b), the action is governed by the applicable state statute of limitations. The Ninth Circuit on two occasions has held that the applicable statute of limitations is the limitation governing actions based on fraud:

"This court held in Fratt v. Robinson,

"203 F. 2d 627 (9th Cir., 1953) at p. 634, that under the Securities and Exchange Act of 1934, the statute of limitations of the State of Washington applied when the unlawful acts occurred in Washington. This is true in our instant case. The applicable Washington statute provides for a three-year statute of limitations for fraud and further provides that the cause of action is not deemed to have accrued until discovery by the aggrieved party of the facts constituting the fraud." Errion v. Connell, 236 F. 2d 447. (9th Cir., 1956).

Section 338(4) of the California Code of Civil Procedure provides a three year limitation for

"... an action for relief on the ground of fraud or mistake. The cause of action in such case not to be deemed to have accrued until the discovery, by the aggrieved party of the facts constituting the fraud or mistake."

c. By both federal policy and the express language of the applicable California statute of limitations, the limitations period does not commence to run until such time as the aggrieved party discovers the facts constituting the fraud.

In the case of Tobacco and Allied Stocks, Inc. v. Transamerica Corp., 143 F. Supp. 323 (D. C. Del., 1956) the court held:

"The leading case in the federal courts

"applying the equitable rule to suits at law is Bailey v. Glover, 88 U.S. (21 Wall) 342, decided in 1874. The Supreme Court held where there has been no fault or want of diligence or care, the bar of limitations included within a federally created right does not commence to run until fraud has been discovered. . . .

"Restated, the federal doctrine means that limitation and laches does not begin to run until evidence of fraud is discovered or could have been discovered had reasonable diligence been exercised. . . ." Id., 328, 329.

The rationale for this rule was stated by Mr. Justice Frankfurter in Holmberg v. Armbrecht, 327 U.S. 392 (1946):

"It would be too incongruous to confine a federal right within the bare terms of a state statute of limitations unrelieved by the settled federal equitable doctrine as to fraud, when even a federal statute in the same terms would be given the mitigating construction required by that doctrine. . . . The mitigating federal doctrine applied in Bailey v. Glover, supra, and in the series of cases following it governs." Id., 397.

d. The complaint is not subject to a motion to dismiss

based upon the statute of limitation.

As a general rule the statute of limitations is an affirmative defense and must be raised in the answer. However, where the complaint shows on its face that the action is barred by the statute of fraud, it may be raised by a motion to dismiss. Fischback & Moore, Inc. v. International Union of Operating Engineers, 198 F. Supp. 911 (S. D. Cal., 1961). It should be noted however, that in order to be subject to a motion to dismiss based on limitations the bar must appear clearly on the face of the complaint and there must not be any disputed question of fact. 1A BARRON AND HOLTZOFF, FEDERAL PRACTICE AND PROCEDURE, §281, p. 190, (Rules edition, 1960) and cases cited therein.

In the instant case the plaintiff has based his action on fraud and has alleged in paragraph XI of the first cause of action, that at the time of purchase of the securities in question, plaintiff was unaware of the fraud that had been perpetrated upon him. Implicit in this allegation is the fact that plaintiff did not discover the fraud until later; and of course the applicable statute of limitations, section 338(4) of the California Code of Civil Procedure, did not start until such time as plaintiff did discover the defendant's fraud. Accordingly, the motion to dismiss does not lie, because the bar of the statute does not appear on the face of the complaint.

2. The Second Cause of Action.

The second cause of action of plaintiff's complaint is based on section 17(a) of the Securities Act of 1933 (15 U. S. C. §77q).

It was held in Osborne v. Mallory, 86 F. Supp. 869 (D. C.

N. Y., 1949), that the considerations governing the selection of a statute of limitations applicable to actions based on section 17(a) of the Securities Act were the same as those applicable to section 10(b) of the Exchange Act. The court there ruled as follows:

> "The applicable statute of limitations to actions under section 17 of the 1933 Act and §10(b) of the 1934 Act would be that of the forum, since the two federal acts do not provide any period within which suits must be brought under those sections. . . . [T]he applicable statute of limitations of the State of New York is found in the New York Civil Practice Act, §48(2) and (5), a six year statute."

The considerations governing selection of the appropriate California statute in the instant case, the tolling of the statute because of undiscovered fraud, and the applicability of the statute as a bar to the present action are discussed at length above and will not be repeated here.

3. The Third Cause of Action.

The plaintiff's third cause of action is based on common law fraud and deceit; and the applicable statute of limitations, section 338(4) of the California Code of Civil Procedure, does not begin to run until the fraud is discovered.

No. 21091

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

JOE TURNER,

Plaintiff and Appellant,

vs.

CHARLES H. LUNDQUIST,

Defendant and Appellee.

Appeal From the United States District Court for the the Central District of California.

APPELLEE'S BRIEF.

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No. 21091

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

Joe Turner,

Plaintiff and Appellant,

vs.

Charles H. Lundquist,

Defendant and Appellee.

APPELLEE'S BRIEF.

A. Statement of the Pleadings and Facts.

The case at bar against Appellee Lundquist was commenced on May 12, 1964, by the filing in the District Court for the Central District of California of a first Amended Complaint by Appellant Turner.

This is an action for damages for fraud under the Federal Securities Acts. The alleged fraud occurred in connection with appellant Turner's purchase, on January 3, 1961, of certain debentures issued by United States Chemical Milling Corporation (USCM). Turner originally sued Roland, the Treasurer of USCM, on April 19, 1963. Later, on May 12, 1964, he filed a First Amended Complaint [Tr. 2]* naming, for the first time, appellee Lundquist, the President of USCM, as a defendant. Lundquist and Roland had both been

*References to transcript of record on appeal are cited "Tr." followed by the page number.

officers and directors of USCM on January 3, 1961. Both the original complaint (against Roland) and the first amended complaint (against Roland and Lundquist) alleged essentially the same facts, except the original complaint made no mention of Lundquist, nor did it allege that anyone acted jointly with Roland. The first amended complaint was framed in three causes of action.

The first cause of action sets forth certain representations alleged to constitute a violation of Section 10(b) of the Securities Exchange Act of 1934 and Rule X-10B-5 of the Rules and Regulations of the Securities and Exchange Commission which induced Turner to purchase $100,000.00 of debentures of USCM.

Moreover, Turner alleged that defendants omitted to inform Turner of certain material facts. Turner alleged (para. XV of the first amended complaint) that if he had known of said facts, or any of them, he "would not have purchased said debentures."

The second cause of action incorporates the same facts, and alleges a violation of Section 17(a) of the Securities Act of 1933, 15 U.S.C.A. Section 77q.

The third cause of action apparently alleges an action for fraud and deceit at common law.

Jurisdiction of the District Court over the first cause of action is based on Section 27 of the Securities Act of 1934, 15 U.S.C.A. Section 78aa.

The District Court's jurisdiction over the second cause of action is based on Section 22(a) of the Securities Act of 1933, 15 U.S.C.A., Section 77v.

The first amended complaint does not state the basis for the District Court's jurisdiction over the third cause

of action, nor does Appellant's Opening Brief disclose any specific basis for jurisdiction. Presumably, jurisdiction as to the third cause of action rests upon the doctrine of pendent jurisdiction.

It is contended that this court has jurisdiction to review the judgment in question by reason of Rule 73(a) of the Federal Rules of Civil Procedure.

Defendant Lundquist's answer [Tr. 11] in addition to containing detailed denials, sets up several affirmative defenses, including the one-year Statute of Limitations under 15 U.S.C.A. 77n and 78r, laches, failure to bring the action within the time within a reasonable time after the facts alleged were discovered or should have been discovered, and the defense that the action was barred by the applicable State laws establishing limitations of action, citing California Code of Civil Procedure, Section 338, subsection 4 (action for relief on ground of fraud—3 years).

Before filing his answer, Lundquist filed a Motion to Dismiss and a Motion for Summary Judgment [Tr. 243] urging that the first amended complaint failed to state a claim against Lundquist upon which relief can be granted, and urging that summary judgment should be granted because the claims against Lundquist are barred by all applicable Statutes of Limitations. This same motion sought to disqualify plaintiff's original attorneys on the grounds that such representation was unethical and unconscionable. This latter motion was granted by the Honorable Gus J. Solomon, but the motion to dismiss and motion for summary judgment were not ruled on at that time.

Later, in Jnue 1965, when the motion to dismiss and motion for summary judgment were renewed, the

same were denied by Judge Solomon, who concluded that although the three year statute of limitations applied, there were several reasons for denying the motion to dismiss, and in a Memorandum Opinion [Tr. 268] dated June 9, 1965, stated:

> "Defendant Lundquist's motion for summary judgment reasserts some of the matters set forth in his motion to dismiss and, in addition thereto, asserts matters which may be contradicted. A motion for summary judgment should never be granted where a claim for relief has been defectively stated. It must appear that no claim for relief can exist. I do not find such a situation here.
>
> "Each of defendant Lundquist's motions is therefore denied."

Judge Solomon then added these significant and prophetic words:

> *"It may be that after a pretrial order is filed, the facts admitted in such order will make the controversy ripe for decision on a motion for summary judgment. In that event, the defendant Lundquist will be given the opportunity to file such a motion."* (Italics added).

Thereafter, a pre-trial conference order was filed February 21, 1966 [Tr. 271].

On March 4, 1966, defendant Lundquist again filed a Motion for Summary Judgment [Tr. 309] which was also a Motion to Dismiss for failure to state a claim and to dismiss the action and each cause of action because barred by the Statute of Limitations.

The Motion for Summary Judgment was based on the same affidavits of Charles H. Lundquist [Tr. 34

and 174] previously filed in connection with the earlier motions denied by Judge Solomon without prejudice.

No pleadings, affidavits or other evidence was filed or introduced by Turner contradicting Lundquist's affidavits to the effect that Turner waited more than three years and four months after purchasing the debentures before suing Lundquist for the alleged fraud. No excuse or avoidance of the Statute of Limitations was pleaded or raised, by affidavit or otherwise, despite Judge Solomon's invitation to do so, *supra.* In fact, the affidavit of James D. Harris, plaintiff's previous counsel, shows that plaintiff knew the facts on which the first amended complaint was based before he ever contacted Harris [Tr. 96] and that "*All* of the evidence and information upon which the first amended complaint is based derives from transactions and events occurring *prior to January 3, 1961.*" (Emphasis supplied). As of the date the renewed Motions [Tr. 309] for Summary Judgment and Dismissal came on for hearing, the first amended complaint showed clearly on its face that the action was barred by the three-year statute of limitations as to the first and third causes of action, and by the one-year statute of limitations as to the second cause of action. No second amended complaint was ever filed, nor were any amendments proposed which would show waiver, extension or excuse of the statute of limitations.

Accordingly, the Honorable Harry Westover granted both the Motion to Dismiss and the Motion for Summary Judgment [Tr. 327], from which Turner has appealed to this Court.

B. Statement of the Case.

Appellant's purported "Statement of the Pleadings and Facts" and "Statement of the Case" in the early portions of his brief are so twisted, confused, and mixed with rank hearsay, conjecture and argument as to be totally misleading and irresponsible. Appellee, who controverts said statements, will therefore set forth the *facts* in this case, as they appear from the *record,* without reference to hearsay or opinion, and without reference to other lawsuits between other litigants about different issues.

Taking as factually correct, for purposes of this appeal, the allegations of plaintiff-appellant Turner set forth in the first amended complaint [Tr. 2], the material portions thereof are as follows:

A close and confidential relationship existed between Turner and Glen R. Roland, who was a director and secretary-treasurer of USCM. (No such relationship between Turner and Lundquist is alleged). As a result of this confidential relationship, defendants Lundquist and Roland were able to induce and solicit Turner between September 1, 1960, and January 3, 1961, to buy debentures from USCM. Defendant Roland, in soliciting Turner to buy said debentures, made seven (7) representations "with the knowledge, consent and assistance of defendant Lundquist". These representations were that:

(1) USCM "was in sound financial condition",

(2) The offered debentures were "a sound, secure investment,"

(3) The debentures were being offered to "sophisticated investors who were purchasing for purposes of long-range investment",

(4) The purchasers were "acquiring said debentures for investment, with no present intention of converting and selling the shares",

(5) The issue would be oversubscribed,

(6) The debentures were exempt from registration under the Securities Act of 1933, and

(7) Financial statements of USCM "which were shown to plaintiff represented truly and fairly the condition of the business and affairs of said corporation."

Turner believed the representations, and on or about January 3, 1961, purchased the debentures and paid therefor $100,000.00, in reliance on said representations. These representations were false and untrue, and defendants knew at the time, or reasonably should have known they were false. In addition to the above affirmative representations, defendants, and each of them on or prior to January 3, 1961, omitted to state or to inform plaintiff of eight (8) material facts. These were that:

(1) Roland was a creditor of USCM,

(2) Defendants stood to benefit from the sale of the debentures,

(3) USCM's financial condition had worsened,

(4) USCM "had suffered drastically changed business conditions and the curtailment of a major military program",

(5) The financial statements issued for the fiscal year ending January 31, 1961, would show greater losses than previously disclosed,

(6) Certain debenture purchasers intended to immediately convert their debentures into common stock,

(7) And sell the stock, and

(8) Roland had invested in, or intended to invest in, a subsidiary of USCM to the detriment of USCM.

Turner further alleges that defendants knew or should have known of these eight (8) omitted facts, but nevertheless failed to disclose them, in order to induce Turner to buy the debentures. Turner didn't know these facts. "If plaintiff had known of such, or any of them," Turner alleges, he "would not have purchased said debentures." Since the debentures are unpaid, and USCM is insolvent and unable to pay them, Turner has been damaged in the amount of the purchase. Adequate allegations of use of mails and interstate commerce are pleaded.

In his original affidavit [Tr. 34] supporting the Motion to Dismiss and for Summary Judgment, Lundquist stated that Turner was, between September, 1960, and January 3, 1961, advised of USCM's continuing losses and the cancellation of the B-70 program and its adverse effect on USCM; that any matters in the first amended complaint which are true were known to plaintiff Turner on or before April 30, 1961, more than three years before the first amended complaint was filed.

In a supplemental affidavit filed September 28, 1964 [Tr. 174], made by Lundquist on personal knowledge, more detailed facts were set forth showing Turner's knowledge of the grave condition of USCM, and at-

tached thereto were Exhibits I through XVII, inclusive. [Tr. 187-242, inclusive].

Lundquist, who was a director of USCM and, until March 16, 1961, its President, also was one of the 15 persons (including Turner) who purchased the debentures of USCM. The Agreement of December 1, 1960 [Tr. 187-188] shows that Lundquist agreed to buy $420,000.00 of the debentures, and Turner agreed to buy $125,000.00, rather than the $100,000.00 alleged in the First Amended Complaint. Turner (as did the other purchasers) agreed to purchase on condition that he received from USCM's counsel a favorable opinion, satisfactory to Turner and his counsel, as to the exemption of the issue from the Securities Act of 1933. [Tr. 189]. Each debenture purchaser was given the right at his option to convert, in whole or in part, his debentures into USCM common stock at $12.00 per share [Tr. 190]. The debentures were expressly made subordinate to "Senior Indebtedness" then or thereafter incurred, which by definition included practically all types of debt except regular accounts payable [Tr. 196]. USCM represented and warranted [Tr. 198], among other things, that "the financial statements, including the balance sheet and income statement as at and to September 30, 1960, and all notes thereto, which were heretofore delivered" to Turner, "present fairly the consolidated financial condition of the company and its subsidiaries at September 30, 1960, and the results of operations", and in Paragraph 9(C) stated:

> "(C) There have been no material adverse changes in the consolidated financial condition of the Company and its subsidiaries, financial or otherwise, since the date as of which the condition of

such corporations is set forth in the financial statements referred to in subparagraph (b) above, *other than as referred to in the accompanying letter of even date herewith, receipt of which you hereby acknowledge.*" (Emphasis added).

The accompanying letter to Turner, dated December 1, 1960 [Tr. 206], states, among other things:

"A net loss of $552,932 on sales of $3,504,504 for the six months ended July 31, 1960 was reported through the financial press following the letter to shareholders, dated August 17, 1960.

"To date, the Company has not returned to profitable operations *and a substantial year-end loss is indicated.*" (Emphasis added).

The August 17, 1960, letter [Tr. 208] which was also sent to Turner, showed first half losses due to defense cutbacks and anticipated profits for the second half, which expectation was not borne out, as shown by the December 1, 1960, letter [Tr. 206].

The September 30, 1960, Consolidated Balance Sheet [Tr. 209], which was also furnished to Turner prior to his debenture purchase, showed that $664,005 of the Subordinated Convertible Notes would be converted into capital stock. The notes to this financial statement [Tr. 211] contained the following passage:

"3. The following transactions are included in the pro-forma statement:

* * *

"B. The proposed sale of $1,664,005.00 of the Company's 6% 10-year subordinated convertible notes — $1,000,000.00 for cash and $664,005.00 in cancellation of existing debt. The pro-forma state-

ment shows the effect of the conversion of the Subordinated Convertible Notes issued in cancellation of indebtedness ($664,005.00) into $55,333 shares of $1.00 per common stock at $12.00 per share *pursuant to an agreement to convert them into common stock prior to 1/13/61.*" (Emphasis added.)

This same Financial Statement [Tr. 210] showed a net loss for the eight months ended September 30, 1960, of $996,187, which was $443,255 greater than the net loss shown for the period ended July 31, 1960, only two months earlier. All of this adverse financial data was furnished to Turner before he purchased the debentures.

On January 30, 1961, which was 27 days after Turner purchased his debentures, Turner was notified by letter [Tr. 223] that $664,005 of the debentures had been converted into stock.

On April 25, 1961 [Tr. 225] Turner was furnished a Consolidated Balance Sheet and Statement of Income and Retained Earnings as at January 31, 1961 [Tr. 226-232], and a copy of a letter to shareholders dated April 18, 1961 [Tr. 233]. The Statement of Income and Retained Earnings showed a loss for the year of $2,489,583, and the April 18, 1961, letter explained that approximately $1,600,000 of this loss was comprised of non-recurring costs. The letter stated:

> "Unfavorable business conditions that prevailed in the aircraft industry, *including the curtailment of a major military program* which necessitated realignment of the Company's manufacturing facilities, were largely responsible for the adverse earnings. . . ." (Emphasis added).

On or about January 3, 1961, coincidental with the purchase of the debentures, Turner received a legal opinion from the Los Angeles law firm of O'Melveny & Myers dated January 3, 1961 [Tr. 217, 218], which pointed out, among other things, that the debenture issue was considered exempt from registration under the Securities Act of 1933 because of the express representations of the purchasers, including Turner, set forth in the December 1, 1960 Agreement [Tr. 200]. The pertinent provisions of this representation were as follows:

> "10. *Representations of the Purchasers.* Each of you, severally and not jointly, represents and warrants, and in making this sale to you it is specifically understood and agreed, that the Notes being acquired by you are being acquired and will be taken and received for your private personal investment for your own account with no intention of reselling or otherwise distributing the Notes and that the shares of Common Stock which you may acquire upon conversion of the Notes or any part thereof will also be acquired by you for your private personal investment for your own account with no intention of reselling or otherwise distributing such shares. You fully comprehend that the Company is relying to a material degree on your representations and warranties contained herein. . . ."

Notwithstanding the investment intent warranty, plaintiff Joe Turner secretly bought $25,000 of his total $125,000 debenture purchase for the account of Glen R. Roland, and later turned over $25,000 in debentures to Roland. On January 29, 1964, at a deposition of Tur-

ner taken by defendant Glen R. Roland's attorney (James White, Esq.), Turner testified under oath that he bought $125,000 of convertible debentures of USCM and that there was an oral agreement between Turner and Roland that Roland (whose nickname was "G.R.") would take $25,000 of them, which agreement was made in the fall of 1960 before the debentures were purchased [Tr. 182, 185]. At said deposition, Turner also testified about the financial advice and investigation he had received from his banker, Mr. Dolph Montgomery, and of other incidents relating to his debenture purchase, as follows:

> "Q. By Mr. White: Before you purchased the debentures in January of 1961, what assistance if any, did you obtain from financial counselors or financial counselor to help you decide whether or not to go into the venture? A. I had my partner, Dolph Montgomery, come out here in the Fall of 1960; I believe probably October or November." [p. 16, lines 15-21]
>
> "Q. In what enterprise or enterprises is or was then Mr. Montgomery your partner? A. He was the President of the City National Bank in Lawton.
>
> Mr. Oeting: (Turner's former attorney) The question was, Mr. Turner, in what enterprise was he your partner.
>
> The Witness: Oh, excuse me. He was a partner in the theater operating company in Lawton.
>
> Q. By Mr. White: Was it your intention that Mr. Dolph Montgomery would take a part of the subordinated convertible debentures? In other words, was he going to be a co-investor with you?

A. No. I don't think so. He had a right to take a look at it, but his purpose was to come out here and check the investment, if it looked good, to loan me the money and loan Roland the money." [p. 17, lines 3-18].

"Q. Would it be a correct statement, sir, to say that Mr. Dolph Montgomery came out her to advise you as a partner, as a friend and as a banker who was going to put up the cash for this transaction? A. Yes.

Q. What information, to your knowledge, was given to Mr. Montgomery when he came out to look into the investment and these convertible debentures? A. He was given the annual financial statement for 1960 that was published in 1960 and then a statement, I believe, as of September, 1960.

Q. All right. Did he go out to the physical plant? A. Yes. We went out there and walked through the physical plant and went to lunch with Mr. Roland." [p. 18, lines 1-15].

"Q. The financial information which was given to you and to Mr. Dolph Montgomery indicated that the company had suffered some rather heavy losses, didn't it? A. Yes.

Q. Can you now recall what kind of losses were involved in accordance with the information that was supplied to you? A. No, I don't.

Q. Did you discuss the matter of the company losses with Mr. Roland? A. Oh, I am sure I did.

Q. When? A. Prior to buying the debentures." [p. 19, line 17, to p. 20, line 3].

"Q. At any time before purchasing the debentures did you discuss the matter with U. S. Chemical Milling with your broker? A. It's possible.

Q. In any such discussion, did you learn of the problems that were besetting the company? A. I am sure that he would have had the same information that I had on the September statement if I talked to him about it. I probably did." [p. 20, line 19, to p. 21, line 1].

"Q. By Mr. White: On Defendant's A (referring to Exh. IV annexed to Lundquist's supplemental affidavit) there is a document called 'Notes to Financial Statement for Period Ended September 30, 1960.'

Paragraph 3B. That talks about this issue of the subordinated convertible notes, does it not, sir? A. Yes.

Q. Did you ask Mr. Willoughby whether or not his conversions came under the terms of that subparagraph, sir? A. No, in fact, I didn't pay any attention to the subparagraph or I would never have complained about it in the first place, would I? I didn't even know that there was anything about converting part of the indebtedness in that thing. I didn't read it.

Q. Mr. Montgomery read it, didn't he? A. Yes." [p. 46, lines 3-18].

"Q. To your present knowledge, immediately prior to the issuance of the debentures, had the position at USCM become materially worse than it had been, say, throughout the prior years? A. No, and I would be sure of this because I was already getting edgy. I found that I was out there

all by myself in this investment and I didn't even have a—we started out to buy a large block of stock and GR was going to go for half of it, and the way it wound up, here I was by myself in the whole thing and I was a little touchy about it, but GR and I spent the Christmas holidays together up at Tahoe. He had rented a cabin up there and we went up there with our wives and the families over the holidays, and that would have been immediately in front of the time for making the investment, and if he had said one word to me about getting out, I think I would have run even then. It wasn't stacking up good. My wife was getting a little bit irritated about it.

Q. You mean this is before you bought it? A. Yes, before the die was cast. I had signed the agreement the first of December.

Q. But you hadn't paid anything in? A. I hadn't put my money in. I could still holler uncle.

Q. You were getting a little nervous. What was it that was making you nervous at the time? A. Well, the fact that we had started out with grand and glorious hopes of making this investment together and going on the notes together and everything, and my way of doing business has always been, if I told you today that I was going to take 25,000 of something you had, tomorrow morning I would be down here with my financial statement and a note and give it to you. You wouldn't

ever have to ask me again about it, and here it was —GR had agreed to take 25,000 of this $125,000 but he didn't ever mention it again, and here we were up there in Tahoe and this kind of irritated me. I, let's say, was irritated with GR. In fact, I was getting so irritated with him that I left early. I insisted that we pack up and get out of there. My wife was getting mad about it, too." [p. 64, line 13, to p. 65, line 26].

"Q. In '61. I see. Did you know that USCM had had a position in the B-70 program? A. Yes.

Q. When did you know about that? A. Oh, I knew that before we ever went into this thing. That was one of the big points in the debenture program." [p. 67, line 24, to p. 68, line 4].

"Q. You have mentioned that there was not any correspondence between yourself and Mr. Roland respecting the debentures. Was there any between yourself and USCM? A. No, nothing other than whatever they sent me in the mail, like those reports and agreements and so forth." [p. 80, lines 7-12].

On May 12, 1964, which was three years, four months and nine days after his purchase of the debentures, Turner commenced his action against Lundquist, by filing the first amended complaint.

C. The Questions Presented.

The basic question presented is whether the matters disclosed to Turner at any time before May 12, 1961, were sufficient to put a reasonably prudent man on notice, so as to start the Statute of Limitations applicable to fraud running.

Subsidiary questions presented are:

(1) Can, and should, this Court consider the "affidavit" of Attorney Levin, who has no first-hand knowledge of any fact, and whose affidavit does not meet any of the requirements of evidence?

(2) Does the first amended complaint, on its face, show that the Statute of Limitations expired before it was filed?

(3) Did the denial, without prejudice, by Judge Solomon of the earlier motions to dismiss and for summary judgment prevent those motions from later being raised?

(4) Can a plaintiff, after filing a lawsuit based upon fraud, and after later joining a co-defendant for the same fraud, re-open a case barred by the Statute of Limitations by discovering more "facts" on which his original cause of action was based?

ARGUMENT.

I.

The Matters Disclosed to Turner More Than Three Years Before His Bringing Suit Against Lundquist Were Sufficient to Put a Reasonable Prudent Man on Notice, so as to Start the Running of the Three-Year Statute of Limitations Applicable to Fraud.

The alleged fraud occurred in California. Since the Securities Exchange Act of 1934 provides no statute of limitations, the three-year California Statute of Limitations applicable to fraud actions applies in this case. This is the finding of Judge Solomon [Tr. 269] and is the rule laid down in *Fratt v. Robinson,* 203 F. 2d 627, at 634.

Section 338(4) of the California Code of Civil Procedure states that the limitation period is three years in:

> "* * *
>
> "(4) An action for relief on the ground of fraud or mistake. The cause of action in such case is not to be deemed to have accrued until the discovery, but the aggrieved party, of the facts constituting the fraud or mistake."

Here, the undisputed record is bristling with facts showing clearly that all the matters Turner complains of were either (1) disclosed to him by express written documentation before the transaction was consummated or (2) brought to his attention more than three years before he sued Lundquist.

The rule in California is that in actions for relief on the ground of fraud, the Statute of Limitations

The following appears in *Wood v. Carpenter,* 101 U. S. 135, 140 [25 L. Ed. 807]:

> "In this class of cases the plaintiff is held to stringent rules of pleading and evidence, 'and especially must there be distinct averments as to the time when the fraud, mistake, concealment, or misrepresentation was discovered, and what the discovery is, so that the court may clearly see whether, by ordinary diligence, the discovery might not have been before made'. . . . A general allegation of ignorance at one time and of knowledge at another [is] of no effect. If the plaintiff made any particular discovery, it should be stated when it was made, what it was, how it was made, and why it was not made sooner. . . . A party seeking to avoid the bar of the statute on account of fraud must aver and show that he used due diligence to detect it, and if he had the means of discovery in his power, he will be held to have known it. . . . There must be reasonable diligence; and the means of knowledge are the same thing in effect as knowledge itself. *The circumstances of the discovery must be fully stated and proved,* and the delay which has occurred must be shown to be consistent with the requisite diligence."

The foregoing is quoted with approval in *Phelps v. Grady,* 168 Cal. 73 [141 Pac. 926]. Other cases recognizing the above principles are: *Original M. & M. Co. v. Casad,* 210 Cal. 71, 74, 75 [290 Pac. 456]; *Newport v. Hatton,* 195 Cal. 132, 146 [231 Pac. 987]; *Victor Oil Co. v. Drum,* 184 Cal. 226, 239-242 [193 Pac. 243]; *Nichlos v. Moore,* 181 Cal. 131, 132 [183 Pac.

531]; *Galusha v. Fraser,* 178 Cal. 653, 657 [174 Pac. 311].

The case last above cited clearly and concisely states the law. It is there declared:

> "Where the plaintiff sues for relief on the ground of fraud and seeks exemption from the three years period of limitation for the reason that he did not discover the fraud until after it was perpetrated, he must not only show [1] that he did not discover the fraud until within the three years next before the action was begun and [2] that the fraud was committed under such circumstances that he would not be presumed t have had knowledge of it at the time, but [3] *he must also set forth the times and circumstances under which the facts constituting the fraud came to his knowledge so that the court may determine from the allegations of the complaint whether the discovery was within that period.*"

Tested by the rules set down in the cited cases, the first amended complaint in the case at bar is deficient and the trial court therefore properly granted appellee's motions. Clearly, the first amended complaint does not satisfy the first two requirements above enumerated in that it nowhere alleges that the fraud was *discovered* within three years of the commencement of suit nor that it was committed under such circumstances as to preclude any presumption of knowledge on plaintiff's part at the time of its commission. Moreover, as already indicated, the cases recognize and declare the existence of a third essential to a valid and proper pleading in a case of this character, viz., an

allegation as to the circumstances surrounding the discovery of the fraud complained of. Such an allegation is necessary in order that the trial court might readily determine whether or not the facts and circumstances leading to the discovery of the fraud existed for more than three years prior to the commencement of suit. It is well settled, of course, that the means of knowledge are the equivalent of knowledge. (*Victor Oil Co. v. Drum, supra; Lady Washington C. Co. v. Wood, supra; Bancroft v. Woodward,* 183 Cal. 99, 108 [190 Pac. 445].) As stated in the case last above cited, "where a party has knowledge of facts of a character which would reasonably put him upon inquiry, and such inquiry, if pursued, would have led to a discovery of the fraud or other ground for rescission, he will be charged with having discovered the fraud or other ground as of the time he should have discovered it, that is, as of the time when he would have discovered it if he had with reasonable diligence pursued the inquiry when he should have done so."

In the instant case no allegation touching these three requirements is raised. For all that appears on the face of the first amended complaint, the facts leading to the inquiry and investigation which uncovered the fraud may have been available to the plaintiff for more than three years prior to the institution of this action. It was incumbent upon plaintiff to allege the circumstances of the discovery in order that the trial court might determine whether or not the information prompting and leading to the investigation was available to plaintiff for more than three years prior to the institution of this action. The complaint here utterly fails to allege any facts showing why such investigation was

not made at an earlier date and, if sooner made, why it would not have disclosed the fraud prior to the running of the period of limitations. True, the complaint alleges the secretive character of the fraud and conspiracy but it was for the plaintiff to show why it could not have been discovered earlier. Any other conclusion would permit a defrauded party, having at all times the means of knowledge at his disposal, to complain of such fraud long after the running of the period of limitations by the simple expedient of alleging that an investigation within three years of the commencement of suit uncovered the fraud. This would place a premium on dilatory tactics and would relieve a party to exercising that diligence required by the law.

Consolidated R & P Co. v. Scarborough, 216 Cal. 698, 704-705.

The affidavit of James Harris [Tr. 97 at lines 3-6 thereof] makes it clear that all allegedly fraudulent acts were admittedly committed prior to January 3, 1961. Therefore, the sole issue is whether at that time there had been discovery by plaintiff of the facts constituting the fraud. *Teitelbaum v. Borders,* 206 Cal. App. 2d 634, 638, 23 Cal. Rptr. 868.

This does not require that the aggrieved party know the exact manner in which his injury was effected, nor the identities of all parties who may have played a role therein. (*Bainbridge v. Stoner,* 16 Cal.2d 423, 430 [106 P. 2d 423]; cf. *Staples v. Zoph,* 9 Cal. App. 2d 369, 370 [49 P.2d 1131].)

In *Bainbridge v. Stoner, supra,* at page 430, the court stated:

"Under ordinary circumstances, a plaintiff may not invoke the aid of a court of equity for relief

> against fraud after the expiration of the period of limitation for such an action unless he affirmatively pleads that he did not discover the facts constituting the fraud until within three years prior to the date he filed his complaint. (Sec. 338, Code Civ. Proc.) The word discovery as used in the statute is not synonymous with knowledge. And the court must determine, as a matter of law, when, under the facts pleaded, there was a discovery by the plaintiff, in the legal sense of that term. Consequently, an averment of lack of knowledge within the statutory period is not sufficient; a plaintiff must also show that he had no means of knowledge or notice which followed by inquiry would have shown the circumstances upon which the cause of action is founded. Moreover, he must also show when and how the facts concerning the fraud became known to him. [Citations.]"

No facts are alleged in the first amended complaint to the effect that appellee Lundquist bore a confidential relationship to Turner. Only Roland is alleged to have stood in such a relationship to Turner. (Roland has since been dismissed from this action.) Lundquist alone is the only defendant.

This lack of an alleged confidential relation between the remaining parties to this law suit is important for two reasons. First, appellant is unable to avail himself of any relaxation of the Statute of Limitations in cases involving confidential relationships. Secondly, the fraudulent concealment necessary to delay the running of the Statute must be that of the defendant (Lundquist). This latter point is clearly spelled out in *Coombes*

v. Getz, 217 Cal. 320 at 335-336 where the Court stated:

> "The rule that an action brought for relief on the ground of fraud shall not be deemed to have accrued until the discovery of the fraud applies only when the fraud, which is the basis of the action, is the fraud of the defendant in the case. It has no application when the fraud charged is that of a third party. This distinction is clearly set forth in a decision rendered by the Circuit Court of Appeals in the case of *Hayden v. Thompson,* 71 Fed. 60, 70, as follows: 'The reason of the rule that the time limited by the statute for the commencement of an action for fraud shall not commence to run while the defendant conceals it is that he ought not to be permitted to take advantage of his own wrong. Neither the reason nor the rule has any application to a cause of action which is fraudulently concealed from the parties in interest by third persons. *The fraudulent concealment of the defendant alone will delay the running of the statute. (Pratt v. Northam,* 5 Mason 95, 112, Fed. Cas. No. 11,376; *Simmons v. Baynard,* 30 Fed. 532; *Stevenson v. Robinson,* 39 Mich. 160.)' "

The three-year limitation applies to all fraud actions whether the relief demanded be legal or equitable.

Knapp v. Knapp, 15 Cal. 2d 237, 242 [100 P.2d 759];

Douglas v. Douglas, 103 Cal. App. 2d 29, 32, 228 P.2d 603.

A motion for summary judgment is a suitable method for testing whether the claim is barred by the Stat-

ute of Limitations. This procedure is useful for avoiding the expense and delay of an unnecessary trial if there is no dispute as to the facts governing this defense and the claim is barred as a matter of law.

> 3 *Barron & Holtzoff,* Fed. Practice & Proc., Rules Edition, Section 1245, p. 206.

> "If the record presented on motion for summary judgment shows that plaintiff cannot successfully refute defendant's plea of limitations, the motion should be granted. If the defendant shows that the applicable period of limitations has elapsed, summary judgment should not be denied on the chance that there might possibly be facts which would toll the Statute of Limitations. In such a case, the plaintiff must show by affidavits, or otherwise, facts which toll the statute." 3 *Barron & Holtzoff, supra.*, p. 207.

Where the record discloses that the plaintiff cannot successfuly refute the defendant's plea of the Statute of Limitations, the plaintiff's cause of action is barred and the defendant is entitled to a judgment as a matter of law.

> *Baker v. Sisk,* 1 FRD 232, 237 (D.C. Okla.) (1938).

California courts have also favored the summary judgment procedure as a method of disposing of claims which are barred by limitations.

The California procedural rule is set forth in California Code of Civil Procedure, Section 437, which provides that a defendant's motion for summary judgment must be supported by affidavits containing facts sufficient to entitle the defendant to judgment. Upon

such a showing the complaint may be dismissed unless the plaintiff, by affidavit, shall show such facts as may be deemed by the judge hearing the motion sufficient to present a triable issue of fact.

Where the affidavits of the moving party are on their face sufficient, and the opposing party fails to come forward with counter-affidavits to show that his case has merit, the motion should be granted.

> *Helfer v. Hubert,* 208 Cal. App. 2d 22, 25, 24 Cal. Rptr. 900;
>
> *Craig v. Earl,* 194 Cal. App. 2d 652, 655, 15 Cal. Rptr. 207.

In the *Helfer* case, *supra,* at 208 Cal. App. 2d, pages 25-27, sets forth a recent summation by a California court of the applicable rules governing summary judgments on the ground of limitations, where the court states:

> "Where the affidavits of the moving party are on their face sufficient, and the opposing party fails to come forward with counteraffidavits to show that his case has merit, the motion should be granted. (*Craig v. Earl,* 194 Cal.App.2d 652 [15 Cal.Rptr. 207]; *Newport v. City of Los Angeles,* 184 Cal.App.2d 229 [7 Cal.Rptr. 497]; *Nini v. Culberg,* 183 Cal.App.2d 657 [7 Cal.Rptr. 146]; *Estate of Kelly,* 178 Cal.App.2d 24 [2 Cal.Rptr. 634]; *Kelly v. Liddicoat,* 35 Cal.App.2d 559 [96 P.2d 186].)
>
> "It is not enough that the complaint alleges sufficient facts. The value of the motion for summary judgment is that it may be used, under the limitations set forth above, to distinguish between

a case raising a genuine issue of fact and one supported only by adept pleading. (See *Coyne v. Krempels,* 36 Cal.2d 257, 262 [223 P.2d 244]; *Hicks v. Bridges,* 152 Cal.App.2d 146, 148 [313 P.2d 15]; *Atchison v. McGee,* 141 Cal.App.2d 515 [296 P.2d 860]; *Schessler v. Keck,* 138 Cal.App. 2d 663, 668 [292 P.2d 314]; *Cone v. Union Oil Co.,* 129 Cal.App.2d 558, 562 [277 P.2d 464].)

"An action for relief on the ground of fraud must be brought within three years, but the cause of action is 'not to be deemed to have accrued until the discovery, by the aggrieved party, of the facts constituting the fraud.' (Code Civ. Proc., §338, subd. 4.)

"The rules governing the application of this statute are summarized in *Hobart v. Hobart Estate Co.,* 26 Cal.2d 412 at p. 437 [159 P.2d 958], as follows:

'The provision tolling operation of the statute until discovery of the fraud has long been treated as an exception and, accordingly, this court has held that if an action is brought more than three years after commission of the fraud, plaintiff has the burden of pleading and proving that he did not make the discovery until within three years prior to the filing of his complaint. [Citations.] Further, although negligence by the person defrauded is not a defense to a promptly brought action based upon intentional misrepresentation [citation], the cases construing section 338, subdivision 4, *supra,* have held that plaintiff must affirmatively excuse his failure to discover the fraud within three years after it took place, by establishing facts showing that he was not negligent in failing to make the

discovery sooner and that he had no actual or presumptive knowledge of facts sufficient to put him on inquiry. . . .

'It is not in every case, however, that a person is barred after three years by failure to pursue an available means of discovering possible fraud. The statute commences to run only after one has knowledge of facts sufficient to make a reasonably prudent person suspicious of fraud, thus putting him on inquiry. Section 19 of the Civil Code provides: "Every person who has actual notice of circumstances *sufficient to put a prudent man upon inquiry* as to a particular fact, has constructive notice of the fact itself in all cases in which, by prosecuting such inquiry, he might have learned such fact." (Italics added.)'

"When the facts known to the plaintiff are susceptible to opposing inferences, the question of whether he has notice of 'circumstances sufficient to put a prudent man upon inquiry' is a question of fact. (*Hobart v. Hobart Estate Co., supra,* at p. 440; *Ramey v. General Petroleum Corp.,* 173 Cal.App.2d 386, 400 [343 P.2d 787]; *Sime v. Malouf,* 95 Cal.App.2d 82, 104 [212 P.2d 946, 213 P.2d 788].) On the other hand, when knowledge had by or imputed to plaintiff is such as to compel the conclusion that a prudent man would have suspected the fraud, the court may determine as a matter of law that there had been 'discovery.' (*Bainbridge v. Stoner,* 16 Cal.2d 423, 430 [106 P.2d 423]; *Lady Washington Consol. Co. v. Wood,* 113 Cal. 482, 486 [45 P. 809]; *Haley v. Santa Fe Land Imp. Co.,* 5 Cal.App.2d 415 [42 P.2d 1078].)"

Applying the foregoing legal principles to the facts in the instant case, it can be seen that matters were brought to Turner's attention both by letters addressed to him which he received, and by meetings and discussions with Roland and others, which should have put a reasonably prudent man on notice that the alleged misrepresentations of which Turner complains were, at best, misunderstandings by Turner because of his failure or refusal or neglect to read the various documents furnished to him as a part of the transaction. Moreover, the alleged omissions to state or inform Turner of materials facts simply evaporate upon examination of the facts, since all of the matters which Turner claims were not disclosed to him were in fact disclosed to him well in advance of the closing of the debenture issue on January 3, 1961, and certainly became known to him upon distribution of the financial statement in April, 1961, more than three years before he sued Lundquist.

Taking as true Turner's allegations that there were seven misrepresentations, the true facts relating to each of these seven misrepresentations became known to him or should have become known to him no later than April, 1961, when the financial statements for USCM for the fiscal year ended January 31, 1961, were distributed to Turner, which financial statements showed a substantial year-end loss [Tr. 233].

Clearly, Turner should have pursued his claim against Lundquist, if in fact he had a claim, long before the date he initiated his action against Lundquist on May 12, 1964. Since the Statute of Limitations is favored by the law (*West v. Cincinnati N.O. & T.P. Railway Co.,* 108 F. Supp. 276 D.C. Tenn. 1953) and

since periods of limitation are established to cut off rights, justifiable or not, that might otherwise be asserted, such periods of limitation must be strictly adhered to by the judiciary.

> *Olin Mathieson Chemical Corp. v. U.S.,* 265 F. 2d 293 (C.A. Ill. 1959).

Here, as both sides admit, the issuer of the debentures, USCM, has since gone bankrupt, a fact from which the court can infer that company personnel have scattered, records have become lost, and memories have faded. To proceed to trial in this case, and attempt to resurrect stale evidence through testimony of accountants and others to disprove the contentions alleged by Turner would undoubtedly place the defendant Lundquist in a position of extreme hardship. It is for this very reason that statutes of limitations have been enacted by the Legislatures.

Statutes of Limitations are statutes of repose and are intended to prevent revival and enforcement of stale demands against which it may be difficult to defend, because of lapse of time, fading of memory, and possible loss of documents.

> *Munter v. Lankford,* 127 F. Supp. 630, aff'd. 232 F. 2d 373, 98 U.S. App. D.C. 116.

Statutes of Limitations are, in their conclusive effects, designed to promote justice by preventing surprises through the revival of claims that have been allowed to slumber until evidence has been lost, memories have faded and witnesses have disappeared.

> *Rothensies v. Electric Storage Battery Co.,* 329 U.S. 296 at pp. 301 and 302, 67 S.Ct. 271, at p. 273, 91 L. Ed. 296.

With respect to the fairness of Statutes of Limitations, the Supreme Court in the *Rothensies* case, *supra,* continues as follows, 329 U.S. at page 301, 67 S. Ct. at page 273:

> "* * *
>
> "The theory is that even if one has a just claim it is unjust not to put the adversary on notice to defend within the period of limitation and that the right to be free of stale claims in time comes to prevail over the right to prosecute."

Accordingly, the judgment of the lower court granting the motion to dismiss and granting the motion for summary judgment should be affirmed.

II.

The "Affidavit" of Attorney Richard H. Levin in Opposition to the Motion for Summary Judgment Is Deficient.

Rule 56(e) of the Federal Rules of Civil Procedure States:

> "(e) FORM OF AFFIDAVITS; FURTHER TESTIMONY. Supporting and opposing affidavits shall be made *on personal knowledge,* shall set forth such facts as would be *admissible in evidence,* and shall show affirmatively that the *affiant is competent* to testify to the matters stated therein. Sworn or certified copies of all papers or parts thereof referred to in an affidavit shall be attached thereto or served therewith. The Court may permit affidavits to be supplemented or opposed by depositions or by further affidavits." (Italics added.)

In opposition to appellee's motion for summary judgment, attorney Richard H. Levin filed and served a "Declaration" which was notarized and therefore presumably constitutes an affidavit [Tr. 316-19]. Rule 56(e) sets forth three requirements for an opposing affidavit: (1) personal knowledge; (2) admissibility; and (3) competency of the affiant.

A fair reading of Attorney Levin's "Affidavit" discloses that not a single one of these three requirements was met.

First, his "personal knowledge" can only be hearsay and opinion. Everything he allegedly learned in this case, he learned "since becoming attorney of record for plaintiff". This happened in March of 1965 (App. Op. Br. p. 6). IN other affidavits and from the first amended complaint itself, it clearly appears that all of the facts upon which appellant's case is based occurred on or before January 3, 1961, and certainly no later than April 30, 1961, approximately four years before Mr. Levin became an attorney in the case and before he examined any records. It is impossible to create "personal knowledge" in Mr. Levin as to any facts involved in this law suit. His review of records might, if he were qualified as an expert witness (which he is not), permit him to give his opinion as to the meaning or content of those records. No such qualifications appear in any of the pleadings or affidavits filed in this case.

Secondly, there are no facts set forth in Mr. Levin's affidavit which would be admissible in evidence. On the contrary, he purports to recite what transpired at a "number of sessions of the bankruptcy proceedings" before Referee Moriarty, without adding that he

only attended three or four sessions out of several dozen which took place. Furthermore, his recollection of what transpired is certainly not evidence, much less admissible evidence. Furthermore, such material as is set forth in Mr. Levin's affidavit, even if it is deemed to be evidence, is not relevant since it merely recites that Mr. Levin discovered facts in the course of an investigation. The date on which a substituted attorney discovers facts is certainly irrelevant when the issue before the court is when did the plaintiff discover the facts upon which his first amended complaint is based. Evidence must be relevant to be admissible.

Uniform Rule 7;

People v. Jones, 42 Cal. 2d 219, 222, 266 P. 2d 38.

In addition, there are policy reasons for excluding Mr. Levin's purported evidence, the most important of which are (1) undue prejudice, (2) unfair surprise, (3) confusion of issues, and (4) undue consumption of time.

See:

McCormick, pp. 314-319;

1 *Wigmore, Section 29a;*

Witkin, Calif. Evidence, p. 134.

Obviously, it is highly prejudicial to appellee to be confronted with a statement by a substituted attorney, who was brought into the case almost two years after it was originally instituted against another defendant, and almost one year after it was instituted against appellee, where the thrust of the new attorney's affidavit is that *he* didn't discover the facts upon which the original and first amended complaint (prepared by a predecessor attorney) were based until after the new

attorney had been substituted in. Certainly, such whimsical "discovery" should not be the basis of denying a motion for summary judgment. Likewise, unfair surprise would be sanctioned if an attorney or a substituted attorney could prevent the disposition of a case in a summary judgment proceeding based on statute of limitations, by the mere allegation that the attorney didn't discover the facts until after the complaint on which the facts were based had been filed and responsive pleadings thereto had been filed. Surely, no attorney going into a trial knows each and every fact which is going to develop during the course of that trial. If, after a law suit had been tried, the attorney could reopen the case and overcome the argument of statute of limitations by merely stating that he had "discovered" a new fact during the course of the trial which he did not have at his disposal at the time the complaint was drafted, the pleadings framed, and previous discovery taken, the statute of limitations could be effectively removed from the law, and the courts would be burdened forever with stale claims.

The purpose of a motion for summary judgment is to accord expeditious justice and to break log-jams in conjested court dockets.

> 3 *Barron & Holtzoff,* Fed. Pract. & Proc., p. 96.

Mr. Levin's affidavit, if considered relevant, certainly confuses the issues and calls upon the court to consume an undue amount of time. All of these reasons militate against the admissibility of such documents.

Finally, the Federal rule clearly requires that the affidavit "show affirmatively that the affiant is competent to testify to the matters stated therein." No-

where is such an affirmative showing set forth in the affidavit. Indeed, no such showing could be set forth in good faith by Mr. Levin since his competency to testify to matters which transpired some four years before he ever learned anything about the case would be nil.

The same rules prevent the admission of any of the other affidavits furnished on behalf of appellant, which make up a part of this record. It is interesting to note that appellant himself never has filed a single affidavit.

For the reasons hereinabove set forth, the affidavit of Richard H. Levin, if it can in any way be construed as constituting an attempt to extend or toll the statute of limitations, should be rejected and disregarded because of its obvious failure to meet the requirements of Rule 56(e).

III.

The First Amended Complaint Shows on Its Face That the Statute of Limitations Expired Before It Was Filed.

The accepted rule that a complaint should not be dismissed for failure to state a claim unless it appears beyond doubt that plaintiff can prove no set of facts in support of his claim which would entitle him to relief (*Connelly v. Gibson,* 355 U.S. 41, 45-46, 78 S. Ct. 99, 102, 2 L. Ed. 2d 80 (1957)) precludes dismissal for insufficiency of the complaint except in the extraordinary case where the pleader makes allegations which show on the face of the complaint some insuperable bar to relief.

> *Wright, Fed. Courts,* 250 (1963);
>
> *Corsican Productions v. Pitchess,* 388 F. 2d 441, 442-443.

The motion to dismiss should be determined upon allegations of the complaint and undisputed facts as they appear from pleadings, orders, and records of the case. The court must enter judgment forthwith if it appears that the moving party is entitled to a judgment as a matter of law.

Vol. IA Barron & Holtzoff, Fed. Pract. & Proc. Sec. 356, p. 369.

It clearly appears from the first amended complaint that it was filed on May 12, 1964. This is the filing stamp affixed in the upper right hand corner. It also clearly appears from the first amended complaint that the alleged fraud occurred between September 1, 1960, and January 3, 1961. There is no allegation anywhere in the complaint as to when plaintiff-appellant discovered the falsity of the misrepresentations or the facts which were concealed. There is no allegation that the concealment or misrepresentation continued after January 3, 1961.

The three-year statute of limitations, which is the longest possible statute of limitations applicable to any of the causes of action, is a matter of law. The very debenture which Turner claims he was fraudulently induced to buy, contains numerous references to the other documentation and agreements that preceded it, all of which would put any reasonably prudent man on notice of the very things of which Turner was complaining.

Therefore, as a matter of law, the first amended complaint shows on its face that the statute of limitations expired before the first amended complaint was filed. Therefore a motion to dismiss was proper and the judgment granting said motion should be affirmed.

The cases cited by appellant in support of the proposition that appellant should have been given an opportunity to remove any technical defect do not apply to the instant case and are not authority to support a reversal. The first case cited by appellant, *United States v. Thurston County, Nebraska,* 54 F. Supp. 201, is authority for the proposition that in ruling on a motion to dismiss, doubt should ordinarily be resolved against the motion; whereas, upon a trial on the merits, doubt usually inclines the scale adversely to him who has the burden of proof. That case did not involve the statute of limitations, Rather, it involved an effort by the United States, as plaintiff, to obtain a judgment on the merits predicated on the fact that the defendant's motion to dismiss had been denied.

In the case of *John Walker & Sons v. Tampa Cigar Company,* 197 F. 2d 72, cited by appellant, which was an action for infringement of trademarks, the District Court dismissed the complaint and the Appellate Court held that the complaint presented a factual issue as to whether or not the defendant's use of the name "Johnny Walker" in connection with its sale of cigars was likely to cause confusion or mistake or to deceive purchasers. The case did not involve the statute of limitations nor did it appear to a certainty from the complaint in that case that the plaintiff could not state a cause of action.

Both the cases of *Black v. First Natl. Bank of Mobile, Alabama,* 255 F. 2d 373, and *Negler v. Admiral Corporation,* 248 F. 2d 319, involved dismissals not going to the merits and the District Court's dismissal in both cases were reversed. Of course, it is the policy of the Federal Courts, pursuant to the Federal

Rules, not to dismiss a complaint that meets the pleading requirements of briefness and clarity. However, where the complaint affirmatively discloses the defect going to the merits of the case, and therefore shows that a cause of action cannot be stated, an order dismissing the complaint is proper and the moving party is entitled to a judgment as a matter of law.

Sheaf v. Minn. St. Paul & S.S.M.R. Rail Co., CCA N.D. 1947, 162 F. 2d 110.

Under Rule 12, a complaint may be dismissed on motion if clearly without any merit, and this want of merit may consist in an absence of law to support a claim of the sort made, or facts sufficient to make a good claim, or in the disclosure of some fact which will necessarily defeat the claim.

DeLoach v. Crowley's, Inc., CCA 5th 1942, 128 F. 2d 378.

Generally, where a complaint alleges facts constituting a claim for relief, and also alleges facts which constitute a valid defense, unless it alleges further facts avoiding such defense it may be attacked by demurrer or motion to dismiss.

Leggett v. Montgomery Ward Co. (C.A. 10th, 1949), 178 F. 2d 436, at p. 439.

The action should be dismissed when the complaint, on its face, shows the bar of limitations.

Suckow Borax Mines Consolidated, Inc. v. Borax Consolidated Limited (1950 C.A. 9th Cal.), 185 F. 2d 196, cert. den. 340 U.S. 943, 95 L. Ed. 680, 71 S. Ct. 506, reh. den. 341 U.S. 912, 95 L. Ed. 1349, 71 S. Ct. 620.

See also:

61 A.L.R. 2d 321, et seq.;

Wright v. Bankers Service Corp. (D.C. Cal. 1941), 39 F. Supp. 980 app. dism.;

Wright v. Gibson, 128 F. 2d 865, holding motion to was proper.

IV.

The Denial, Without Prejudice, by Judge Solomon of the Earlier Motions to Dismiss and for Summary Judgment Did Not Prevent Those Motions From Later Being Raised.

Plaintiff cites the case of *Commercial Union of South America, Inc. v. Anglo-South American Bank,* 10 F. 2d 937, in support of his contention that the denial by Judge Solomon of the motion to dismiss constituted the law of the case and bound Judge Westover so as to preclude Judge Westover from ruling on that motion when it was renewed. The *Commercial Union* case, *supra,* was decided before *Erie v. Tompkins* and did not involve a situation at all similar to the instant case where Judge Solomon in his Memorandum Opinion of June 9, 1965, carefully indicated that the denial of the motion was without prejudice and could be renewed after the pre-trial order was filed [Tr. 321-322]. Had Judge Mack, in making his original decision in the *Commercial Union* case, *supra,* added the proviso set forth by Judge Solomon entitling the defendant to renew his motion after the pre-trial order clearly the decision of the Court of Appeals in the *Commercial Union* case would have been different.

Moreover, appellant Turner completely overlooks the fact that the obvious purpose of Judge Solomon's reser-

vation of the court's right to rehear the motions was an open invitation to Turner to contradict the matters asserted by Lundquist in his affidavits [Tr. 321]. Such contradiction was never forthcoming from appellant, unless we consider the "affidavit" of Mr. Levin, which for reasons stated above should be disregarded.

Accordingly, and in view of the express reservation of the court to rehear the matter on motion, the ruling of Judge Solomon did not becomes *res judicata* on the question of whether defendant-appellee was entitled to judgment.

Conclusion.

An examination of the conclusions set forth in Appellant's Opening Brief shows that they are without merit.

The supposed agency relationship (App. Op. Br. p. 30) must of necessity have been merely a relationship existing between USCM as principal and Roland and Lundquist as its agents. Since plaintiff did not see fit to join USCM as a party, and did not allege that Roland was Lundquist's agent or that Lundquist was Roland's agent, nor did appellant state in his pleading any reason for not joining USCM, no agency relationship was alleged.

Rule 19(c), F.R.C.P.

On pages 31 and 32 of his Opening Brief, appellant admits that discovery had been completed and the proposed exhibits had been filed. This alone would furnish the basis for reopening the motion in accordance with the suggestion of Judge Solomon, since the exhibits *proposed to be offered by plaintiff-appellant*

[Tr. 284-290] include the agreement dated as of December 1, 1960 [Tr. 187], the 6% note [Tr. 203], the December 1, 1960 letter [Tr. 206], the August 17, 1960 letter [Tr. 208], the financial statement for the period ending September 30, 1960 [Tr. 209], the letter of December 21, 1960 [Tr. 212], the annual report for the fiscal year ended January 31, 1961 [Tr. 285], all of which clearly show that Turner had knowledge, sufficient to put a reasonable man on inquiry, as to each of the alleged misrepresentations and omissions, well prior to three years in advance of the date he sued Lundquist. Thus, rather than contradicting Lundquist's affidavits, Turner confirmed them.

On page 32 of his Opening Brief, appellant, apparently through the ignorance of his counsel, mis-states the record by suggesting that defendant Lundquist should have opposed appellant's original motion to add Lundquist as a defendant, and that the trial court thereupon might have denied Turner's application to add Lundquist as a party. Appellant overlooks the facts that this motion was *ex parte* insofar as Lundquist was concerned, and Lundquist was not even served until July 14, 1964.

Appellant has had his day in court. In fact, he has had several days in court. In an effort to generate a case where none exists, he has made allegations of fraud and omission which would require weeks if not months of testimony, including the testimony of accountants and other experts, to refute. Appellant's entire case is based on his ignorance of facts, all of which were clearly spelled out in the documentation furnished as part of the debenture transaction, receipt of which he acknowledges in the pretrial statement.

It is hard to see a case that more clearly lends itself to speedy disposition by the summary judgment procedure than the present one.

Appellee respectfully urges this court to confirm the judgment of the District Court in granting the motion for summary judgment and the motion to dismiss.

Respectfully submitted,

Hurley & Driscoll,
By Robert W. Driscoll,
Attorneys for Defendant-Appellee.

N O. 2 1 0 9 1

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

JOE TURNER,

Plaintiff and Appellant,

vs.

CHARLES H. LUNDQUIST,

Defendant and Respondent,

APPELLANT'S CLOSING BRIEF

APPEAL FROM
THE UNITED STATES DISTRICT COURT
FOR THE CENTRAL DISTRICT OF CALIFORNIA

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FILED

DEC 27 1966

WM. B. LUCK, CLERK

NO. 21091

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BOTH THE MOTION TO DISMISS AND THE MOTION FOR SUMMARY JUDGMENT SHOULD HAVE BEEN DENIED BECAUSE THE AMENDED COMPLAINT DOES NOT AFFIRMATIVELY SHOW ON ITS FACE THAT THERE IS AN INSUPERABLE BAR TO RELIEF

Appellee, at page 38 of his brief, sets forth the rule that a claim will be dismissed only in "the extraordinary case where the pleader makes allegations which show on the face of the complaint some insuperable bar to relief." On page 41 he reiterates this test in slightly different terms: "... where the complaint affirmatively discloses the defect going to the merits of the case, and therefore shows that a cause of action

cannot be stated." Applying the test to the case at hand, Appellee contends that the Appellant's omission of an allegation showing that the fraud alleged was discovered within three years of the filing of the suit, renders the complaint incurably vulnerable to the statute of limitations - that such omission "affirmatively" discloses an insuperable defect. This contention is without support of authority from Appellee's brief.

It is significant that, as a general rule, a plaintiff has no obligation to plead the inapplicability of the statute of limitations. Instead, the defendant must affirmatively plead the statute as a defense. Moore's Federal Practice, p. 1862. California courts, however, require that a plaintiff plead that discovery of the fraud occurred within three years of the commencement of the action whenever the action is filed more than three years after the actual fraudulent conduct. In addition, California courts require the plaintiff to set forth the specific acts of such discovery. Appellant respectfully submits that: 1. The California law in this respect is procedural and should not be applied by this court; and 2. even if the California law was applicable in this case, the failure to comply with the pleading requirement would not produce an "affirmative disclosure" of an insuperable bar to relief

as required for the dismissal of a claim.

The California Rule Requiring the Plaintiff to Affirmatively Plead That The Fraud Was Discovered Within Three Years Of The Commencement Of The Action Is Procedural And Need Not Be Applied By This Court

California courts actually require a plaintiff to plead both the time the discovery was made and the precise facts of such discovery. However, it was decided in Owens Generator Co., Inc. v. H.J. Heinz Co., 23 F.R.D. 121 (N.D. Calif. S.D. 1958) that the California requirement that the specific circumstances of discovery be plead is a procedural one which is not necessary in federal courts. In that case, the plaintiff alleged discovery of the fraud within three years of the commencement of the action but the defendant moved to dismiss the complaint because it failed to set forth the facts attending such discovery. In denying the motion to dismiss because the California rule was procedural and did not bind a federal court, the court stressed the applicability of Conley v. Gibson, 355 U.S. 41 (1957) which stated:

> ... a complaint should not be dismissed for failure to state a claim unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief.

Although the court in the Owens Generator case, supra addressed itself specifically to the issue of whether or not the facts of discovery of the fraud must be plead in a federal court, the opinion clearly inferred that the policy stated in the Conley case supra would also prevent an omission of an allegation of when the fraud was discovered from totally barring a claim in a federal court. Appellee has cited absolutely no authority which requires a federal court to apply the California pleading rule at all, let alone in instances where the rule would result in the dismissal of a claim. In fact, the authority of the Owens Generator case is contrary.

Appellant submits that under the facts of this case, where he has repeatedly demonstrated his willingness and ability to prove that discovery of the fraud was within three years of the action, that his complaint was erroneously dismissed for failing to plead avoidance of the statute of limitations.

In Any Event, The Omission Of An Allegation That The Fraud Was Discovered Within Three Years of The Commencement of the Action Does Not Constitute An Affirmative Disclosure of an Insuperable Bar To Relief Justifying Dismissal of the Action

The omission of an allegation that the fraud was discovered within three years of the suit is not an

affirmative disclosure of any defect. In fact, the omission discloses nothing. It does no more than raise the possibility of a bar by the statute of limitations. Clearly, the defect (if it is so deemed) is not insuperable for a simple allegation that the fraud was discovered within three years of filing would remedy the complaint beyond question, and such an allegation is in fact set forth by plaintiff in his pre-trial statement. (Plaintiff's contentions of fact - C. T. 341, etc.)

In his attempt to characterize Appellant's alleged pleading oversight (according to California law) as a fatal affirmative allegation, Appellee's authority is, again, non existent. Though Appellee cites several cases, none are directly in point and some are entirely irrelevant. The following is a brief analysis of the cases cited on pages 41 and 42 of Appellees brief:

Sheaf v. Minn. St. P. & S. S. M. R. Co., 162 F. 2d 110 (8th Circuit 1947) - did not deal with statute of limitations at all. The Court dismissed a claim under the Federal Employer's Liability Act because the plaintiff failed to allege a causal relationship between an unprovoked attack on him by a fellow worker and the asserted negligence of the employee.

De Loach v. Crowley's, Inc., 128 F. 2d 378 (5th Circuit 1942) - did not deal with statute of limitations.

The Court reversed the dismissal of a claim under the Fair Labor Standards Act giving the plaintiff leave to amend to clarify his complaint.

Leggitt v. Montgomery Ward Co., 178 F. 2d (10th Circuit 1949) - did not deal with statute of limitations. The Court held that under Wyoming law the binding over of a criminal defendant by an examining officer to a court is prima facie evidence of probable cause and where it affirmatively appeared on the face of a complaint that the plaintiff, on advise of counsel, waived preliminary examination, the complaint was properly dismissed.

Suckow Borax Mines Consolidated, Inc. v. Borax Consolidated Ltd., 185 F. 2d 196 (9th Circuit 1950), cert. den. 340 U.S. 943; reh. den 341 U.S. 912 - Affirmative allegations of the plaintiff in an action for treble damages under the antitrust laws showed that the action was barred by the statute of limitations.

Wright v. Bankers Service Corp., 39 F. Supp. 980 (D.C. Calif. 1941) - at page 983 the Court stated: "The allegations of the complaint show that the alleged fraud was discovered and the plaintiff had knowledge thereof more than three years prior to the filing of the complaint." Such is clearly not the case at hand.

Wright v. Gibson, 128 F. 2d 865 - did not deal with statute of limitations. It held: a judgment

dismissing one count of a two count complaint is not a final decision and is therefore not appealable.

Appellant submits that the foregoing analysis demonstrates the paucity of legitimate authority supporting Appellee's contentions. He has not cited one case where a federal court has dismissed a claim for its failure to allege that the fraud was discovered within three years of the filing of an action. In the absence of such authority, and in view of the federal policy to treat pleading defects most liberally, the judgment granting the motion to dismiss and the motion for summary judgment should be reversed.

LEAVE TO AMEND SHOULD HAVE BEEN GRANTED BECAUSE APPELLANT COULD HAVE CURED ANY DEFECT IN THE COMPLAINT

This court, in Tipton v. Bearl Sprott Co., 175 F. 2d 432 (9th Circuit 1949), has held that although a ruling on a motion to dismiss is good as to a particular complaint, where it is shown that other facts exist which would cure the defects, if alleged, leave to amend should be granted. The court in Topping v. Fry, 147 F. 2d 715 (7th Circuit 1945) stated the principle even more broadly holding that a dismissal without leave to amend should not be granted where there is a possibility of a good complaint being filed. This Court, again, in Sidebotham v. Robison, 216 F. 2d 816, 826 (9th Circuit 1954) further expanded the principle stating that it

should apply even where no request to amend the pleading was made to the district court.

The defect asserted here by the Appellee, if it does exist, is purely a technical one which the Appellant can remedy by amending his complaint and submitting new affidavits. The great weight of authority indicates that the Appellee's plea for a rigid, one-shot approach to pleading be rejected. The Appellant's valuable substantive rights should not be foreclosed by an alleged procedural technicality. Appellant has stated a claim for relief. And in any event Appellant can state a claim for relief and he should be permitted to do so.

SIGNIFICANCE OF JUDGE SOLOMON'S ORDER

The original motions to dismiss and for summary judgment filed by Lundquist were made to Judge Solomon and denied by that judge. Judge Solomon denied these motions with the further statement that it may be that after a pre-trial Order is filed the facts admitted in such order will make the controversy ripe for decision on a motion for summary judgment.

Appellee contends that by reason of the above, Appellant was placed on notice that an amended Complaint was in order (Appellee's brief, p. 5).

Appellant submits that this is a distorted interpretation of Judge Solomon's Order. Appellant urges that on the contrary, Judge Solomon was stating as the law of the case that the complaint was sufficient and that in the absence of appropriate admissions in the pre-trial statement, Lundquist's motions should not be renewed. In the pre-trial statement Plaintiff made no admissions relevant to the motions to dismiss or for summary judgment. Hence Judge Solomon's Order should remain the law of the case. Having relied on Judge Solomon's ruling that the Plaintiff was not vulnerable to a motion to dismiss or to a motion for summary judgment, Plaintiff should not now be thrown out of Court because of such reliance.

Respectfully submitted,

RICHARD H. LEVIN

Attorney for Plaintiff and Appellant.

CERTIFICATE

I certify that in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

RICHARD H. LEVIN

No. 21097

In the

United States Court of Appeals For the Ninth Circuit

UNITED PACIFIC INSURANCE CO.,

Appellant,

vs.

IDAHO FIRST NATIONAL BANK,

Appellee

IDAHO FIRST NATIONAL BANK,

Cross-Appellant,

vs.

UNITED PACIFIC INSURANCE CO.,

Cross-Appellee.

BRIEF OF APPELLANT

On Appeal from the District Court of the United States for the District of Idaho, Southern Division

FILED

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CLEMONS, SKILES & GREEN
Counsel for Appellant
Res: Boise, Idaho

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Counsel for Appellant
Res: Boise, Idaho

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BRIEF OF APPELLANT

JURISDICTIONAL STATEMENT

The plaintiff, The Idaho First National Bank, is a national banking association with its principal place of business at Boise, Idaho. The defendant, United Pacific Insurance Company, is a corporation organized under the laws of the State of Washington and licensed to do business in the State of Idaho.

Jurisdiction is based upon diversity of citizenship and that the amount in controversy exceeds $10,000.00 (Tr. Vol. 1, pp. 4-5, 11, 32), exclusive of interest and costs.

STATEMENT OF THE CASE

The nature of the case is fully covered by the pre-trial order (Tr. Vol. 1, pp. 32-36) entered in the case prior to trial. However, Appellant has appealed only from the Judgment entered as to Count I of the complaint.

The action was instituted by Appellee (also cross-appellant) under the terms of a banker's blanket bond issued by Appellant to Appellee. Count I of the complaint alleges that Appellee suffered loss of property in the amount of $10,494.70 due to the cashing of certain sight drafts executed by Gem Creamery Company, and that the loss was one caused by false pretenses and therefore covered by the provisions of Clause (B) of the Bankers Blanket Bond, Standard Form No. 24, which covered:

> "any loss of property through * * *
> theft, false pretenses * * *."

Under a Rider (Tr. Vol. 1, p. 14, plaintiff's Exhibit 4 and defendant's Exhibit 5) insuring Clause (D) was deleted, thereby deleting:

> "any loss through forgery or alteration
> of, on or in any checks, drafts * * *"

Also the application for the bond excluded loss through forgery (Def. Ex. 5).

In Count I Appellee alleges (Tr. Vol. 1, pp. 5-6) on or about February 19 and 20, 1963, employees of Gem

Creamery Company presented certain instruments to the Broadway Office of the appellee bank, and on February 18, 19 and 20, 1963, employees of Gem Creamery Company, presented certain instruments to the Capital Office of the appellee bank (Tr. Vol. 1, p. 6) and that the instruments were cashed by the two offices of the bank.

The instruments so alleged by Appellee to have been cashed by the two branches of the appellee bank were all sight drafts (plaintiff's Exhibits 2, 2(a) - (m) and plaintiff's Exhibits 3, 3(a) - (sl) (Tr. Vol. 3), and were presented for payment but have not been honored.

The Gem Creamery Company issued sight drafts and had an arrangement with the First Security Bank at Emmett, Idaho, whereby the drafts would be forwarded to the bank. At the end of the day the Bank would notify the Creamery of the drafts received that day. The Creamery would then pick up the drafts and issue a check in payment. (Testimony of Fischer, Vol. 2, Tr. pp. 24-26).

Drafts had been presented to, and accepted by, the two branch banks in question over a period of time by different employees of the Gem Creamery. On the dates in question, drafts were presented and were accepted by tellers of the bank. There were no questions asked, and no representations made, as to whether the drafts would be honored on presentment or whether any funds were on deposit, or held, to cover the same. The only interrogatory as to funds available to pay any draft at all was some 8 months before the dates in question. (Tr. Vol. 3, p. 9-10), (Tr. Vol. 2, pp. 95-97, testimony Barrett), (Tr. Vol. 3, pp. 9-12, testimony Cegnar), (Tr. Vol. 3, pp. 17-19, testimony Hoskins),

(Tr. Vol. 3, pp. 24-27, testimony Neuman), (Tr. Vol. 3, pp. 27-28).

Subsequent to the dates herein referred to, and the cashing of the drafts which are the subject of Count I, the Gem Creamery Company was forced into involuntary bankruptcy which was later consented to. (Tr. Vol. 3, p. 28).

SPECIFICATIONS OF ERROR

Appellant contends the court erred:

1. In admitting evidence (Tr. Vol. 2, pp. 49-50) (Tr. Vol. 2, pp. 57-58), as to cashing of drafts at business locations other than Appellee's and in entering Finding of Fact No. V.

2. In entering Finding of Fact No. VI in that it is not sustained by the evidence.

3. In entering Finding of Fact No. IX particularly as to the handling of the drafts as cash items.

4. In entering Finding of Fact No. X particularly as to the handling of the drafts as cash items.

5. In receiving evidence for (Tr. Vol. 2, pp. 57-58) and making and entering Finding of Fact No. XIV, which includes drafts presented at business locations other than Appellee's.

6. In entering Finding of Fact No. XVI in that it is contrary to the evidence.

7. In entering Findings of Fact numbers XVII, XVIII and XIX and thereby finding that false representations were made at the time of cashing of the drafts, which is contrary to the evidence.

8. In making and entering Conclusion of Law No. II.

9. In making and entering Conclusion of Law No. IV.

10. In making and entering Conclusion of Law No. V.

11. In not finding that there was no representation that funds were available for payment of such drafts, and the loss, if any, was through the acceptance of drafts which does not constitute false pretenses.

12. In not entering its Conclusion of Law that the issuance and acceptance of drafts, as shown by the evidence herein, does not constitute false pretenses.

13. In not finding that the sight drafts were in fact forgeries.

14. In not entering its Conclusion of Law that the sight drafts were forgeries.

15. In not finding in favor of Appellant on Count I of the Complaint.

16. In entering Judgment against Appellant on Count I.

SUMMARY AND STATEMENT OF QUESTIONS PRESENTED

Appellee contends that it suffered a loss of property by reason of cashing the drafts and that the loss is one caused by false pretenses. Appellant contends that if there was a loss: (1) it was not a loss caused by false pretenses, and (2) the drafts were in fact forgeries. (Tr. Vol. 1, pp. 33 and 34).

ARGUMENT

I

A DRAFT DOES NOT CONSTITUTE FALSE PRETENSES.

As stated in 11 Am. Jur. 2d, Bills and Notes, Section 14 at page 43, "A draft in the law of bills and notes is a 'drawing' and has been defined as an open letter of request from, and an order by, one person upon another to pay a sum of money therein mentioned to a third person on demand or at a future time therein specified." On the other hand, a check, as is stated in Section 16 of the same authority at page 45, is an order drawn upon a bank purporting to be drawn upon a deposit of funds. And at page 48, Section 18 of the same authority, it is stated that the characteristics of a check as distinguished from usual bills of exchange are that a check is payable instantly upon demand and not at a specified future time, and that a check is supposed to be drawn on a previous deposit of funds, while a draft is not.

The distinction is aptly explained in *Wilson v. Buchenau*, 43 F. Supp. 272:

> "A draft has been defined as an open letter of request from, and an order by, one person on another to pay a sum of money therein mentioned to a third person on demand or at a future time therein specified. * * * The two chief characteristics of checks are that they are drawn on a bank and are payable instantly on demand. * * * A check differs from a bill of exchange in that it is always drawn on a deposit while a bill is not. * * *"

Also drafts to be paid by a person, either upon demand or upon sight or upon presentment or notice should be distinguished from drafts between banks which are ordinarily placed in the same category as checks and predisposes a deposit of funds or an obligation to meet the demands of the bank.

The drafts involved herein were headed "General Draft," were payable at sight to the order of certain persons through the First Security Bank of Idaho and signed by an officer or partner of the Gem Creamery Company. Under the law of negotiable instruments, and in civil law, a draft is payable upon demand or upon presentment. However, a reasonable time for presentment is presumed so as to hold those secondarily liable. In other words, unlike a check, it is not a promise that funds are on hand but that if it is presented to the maker he will honor the draft. Presented to the Appellee bank in this case, the draft, on its face, only constituted authority to present to the Emmett bank for payment.

The complaint in this case seeks recovery under Clause (B) of the banker's blanket bond, standard form No. 24, which insures any loss of property through robbery, burglary, common law or statutory larceny, theft or false pretenses. Almost all of the authority as to the definition as to false pretenses occurs in criminal cases. However, the term "false pretenses" should not be so broadly construed in this case as it is in criminal cases. In criminal cases the person is answering for his own act, here the insurer is not. Here is a contract between the Appellant and Appellee, and there is no definition of the term. Under such circumstances we think it is universally held that the false pretense must relate to a present existing or to a past fact.

In *People v. Green*, 22 Cal. App. 45, 133 Pac. 334, where the court speaking about the necessary element of false pretense said:

> "Statutes of this character have been the subject of judicial construction throughout this country in a

great many cases; and the decisions of the court of last resort are in accord to the effect that in order to constitute a false pretense in law the misrepresentations must be of an existing or past fact, and cannot relate to the future, or be a mere promise to pay * * *"

Then after discussing parts of the evidence, the court in regard to the legal effect of a sight draft relied upon in that case, said:

"Respondent, referring to the sight drafts given by Green, Foster and Lehmann in payment of the goods obtained, requests that the character of these so-called sights be determined. The instrument set out in the indictment is in the following form: * * * It is, we think, apparent that this instrument purports to be nothing more than an order drawn by Green, Foster & Lehmann upon themselves for the payment of money, and cannot by any process of reasoning whatever constitute anything more than a promise by the maker to pay the sum therein named upon presentation. True it carries with it the implied representation of the ability of the drawer to do so; but what does that implied representation amount to? It amounts to a representation of future ability, for clearly some time was to elapse between the issuing of the draft and its presentation and payment, and thus comes within the class of representations as to future events which will not, according to the authorities, sustain a charge of the making of false pretenses.

"It is urged that the prosecuting witness parted with his property on the strength of the issuance to him of this sight draft. If so, he parted with it upon the strength of a promise to pay, in which respect

the transaction does not differ from the ordinary sale of goods, on credit, and the issuing of the drafts, as shown by all the circumstances of the case, was an arrangement adopted for the payment for the goods as purchased.

"The case of People v. Wasservogle, 77 Cal. 173, 19 Pac. 270, is not at variance with the views here expressed. In that case the passing of the draft was accompanied by the statement that the drawer had funds in the hands of the drawee with which it would be paid. The conviction was upheld upon this statement, which amounted to a representation of an existing fact. The court, however, expressly recognized the rule that a pretense must be of a past or existing fact."

The above cited case, People v. Green, is of interest here in Idaho in respect to the instant problem, particularly with respect to the fact that the pretense must relate to past or existing fact. The rule which has been followed in this state is expressed in *State v. Whitney*, 43 Idaho 745, 254 Pac. 525, as:

"* * * four things must concur, and four distinct averments must be proved: (1) there must be an intent to defraud; (2) there must be an actual fraud committed; (3) false pretenses must be used for the purpose of perpetrating the fraud; and (4) the fraud must be accomplished by means of the false pretenses made use of for that purpose; viz, they must be the cause which induced the owner to part with his property.

"The essence of the crime of obtaining money by false pretenses lies in obtaining the money with intent to defraud. A false pretense has been defined

to be a fraudulent representation of an existing or past fact by one who knows it not to be true, adapted to induce the person to whom it is made to part with something of value."

This same rule has been followed in this state in regard to prosecutions relating to checks, although the court in criminal actions has been inclined to construe evidence favorable to the prosecution, *State v. Larson*, 76 Idaho 528, 286 P. 2d 646, *State v. Eikelberger*, 72 Idaho 245, 239 P. 2d 1069, if there is any fact tending to show a false pretense of an existing fact.

But regardless of the criminal statute, we have here a contract between the two parties. The words false pretense certainly cannot be given a meaning of something promised to be done in the future.

It should be noted that all bank tellers testified that at the time of such cashing the drafts there was no conversation in regard to payment of the drafts or funds for such payment. (Tr. Vol. 3, pp. 10, 18-19, 25, 28). Apparently some 8 months before the drafts were cashed a Mr. Miller had authorized that drafts be accepted, there being no evidence as to any representation, even at that time, having been made to the Appellee as to the payment of the drafts (Tr. Vol. 3, pp. 11, 28).

On the other hand, the court admitted evidence that drafts had been cashed at other business locations (Tr. Vol. 2, testimony Hay, p. 49, etc., Drown, p. 56, etc., LeMaster, p. 63, etc.), although LeMaster testified that the only time he inquired as to the validity of the drafts was approximately six to eight months before the losses occurred (Tr. Vol. 2, p. 68), and that inquiry, as were any others, was made to the First Security Bank

at Emmett, Idaho. There is no evidence whatsoever that the makers or the payees of the drafts at any time made any pretense, false or true, as to the ability to make payment of the drafts, and particularly the drafts involved herein, nor is there evidence that inquiry was made as to Gem Creamery Company, the only inquiries apparently being made to First Security Bank.

II.

FORGERY BY MEANS OF FALSE INSTRUMENT

Forgery is not limited to the signing of another's name to an instrument. It may consist also of the signing of one's true name to a false instrument. In the instant case, we may treat the sight drafts as false instruments by reason of the fact that there were no funds to honor the same.

The case of Ex Parte Hibbs, 26 Fed. 421, may be considered upon both questions of whether a false draft is a forgery, rather than false pretense, and also whether forgery and counterfeit are one and the same.

In the Hibbs case, the defendant was Postmaster at Lewiston, Idaho. He made out postal money orders to a fictitious person at Pierce City, and converted the funds to his own use. The court held:

> "The crime defined in this statute is the common-law crime of forgery, with reference to the money order. To 'falsely make, forge, counterfeit, engrave or print' are all cognate terms used to define or designate the crime of forgery in some of its many phases. * * *

* * *

"However, it is contended that a person cannot commit a forgery by making a false writing in his own name. But it must be borne in mind that forgery is not necessarily confined to the false writing of another's name. It may be, from the very nature of things, that it is more often than otherwise committed in that way; but both reason and authority say it may be committed in other ways * * *

* * *

"The notion of forgery doth not so much consist in the counterfeiting of a man's hand and seal, * * * but in endeavoring to give an appearance of truth to a mere deceit and falsity * * *

"And if the deceit consist in making it appear that a man's own act was done under circumstances which would make it valid and genuine, when in fact it was false and unauthorized, the result is the same * * *"

And again at page 434 in the same case:

"It is not necessary to consider whether the prisoner committed forgery in writing the name of J. G. Wilson on the back of the three drafts on the Omaha bank. Forgery may be committed by thus writing the name of a fictitious person on an instrument. If the existence of such a person is a question of fact and not law, and the instrument appears to be valid on its face, the offense is complete, provided the act was done with intent to defraud. * * *"

It appears that the term "forgery" includes "counterfeiting." Thus in Quick Service Box Co. v. St. Paul Mercury Indemnity Co., 95 F. 2d. 15, it was said,

"Then, too, though one may under certain condi-

tions have authority to sign certain names, yet if he sign such to a false document or to an unauthorized one, it is forgery. Such was the conclusion of the court in Ex Parte Hibbs, D. C., 26 F. 421. The court commented that it must be borne in mind that forgery is not necessarily confined to the false writing of another's name. It may be committed in other ways. The essence of forgery does not so much consist of counterfeiting as in endeavoring to appearance of truth to a mere deceit and falsity * * *"

We think that the case of Peoples Bank & Trust Co. v. Fidelity & Casualty Co., 231 N. C. 510, 57 SE 2d. 809, 15 ALR 2d. 996, is authority upon all of the legal points involved here.

In that case, as here, the policy insured against loss through various causes, including false pretenses. A rider to the policy deleted Clause D, and thus withdrew from coverage any loss effected directly or indirectly by means of forgery.

In that case, one Otho Langley, who did not have an account at the bank, discovered that his signature would pass for that of another man who did have an account at the bank. On various occasions he would inquire as to "his" bank balance and cash checks.

To arrive at a definition of forgery, the court first examined the statutes denouncing certain acts as criminal acts described as forgery, and also the common law definition of forgery, the court said,

"From these definitions we find that the essentials to the completion of the offense are: (a) The falsification of a paper, or the making of a false paper, of legal efficacy apparently capable of effecting a

fraud; (b) the fradulent intent 37 C.J.S. Forgery, Sec. 3 * * *

"False pretense and forgery are closely akin, both belonging historically to the family of offenses known to the common law as 'cheats,' and now so classed. False pretense is the heart of forgery—the essence of its being. The principal difference between the two, historically developed in the common law, is that forgery exclusively pertains to a writing, while false pretense covers fraudulent deceits by parol. Treatment of forgery as a separate offense came from recognition that a fraud perpetrated in altering a writing or making a false writing tends directly to destroy the security which permanent monuments in writing give to transactions affecting the more important rights of persons privy to them. It became a separate and grave offense; but the *gist* of forgery is still *fraud*. * * *

On page 816 of the S. E. Report, the court also said,

"* * * Under a policy which expressly rejects liability for any loss effected directly or indirectly by forgery it makes no difference which was the crime and which the adulterant."

Respectfully submitted

CLEMONS, SKILES & GREEN

By______________________________

Attorneys for appellant

CERTIFICATE

We certify that in connection with the preparation of this brief, we have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in our opinion, the foregoing brief is in full compliance with those rules.

CLEMONS, SKILES & GREEN

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Receipt of three copies
accepted this ____ day of
October, 1966.

LANGROISE, CLARK & SULLIVAN

By______________________________

Attorneys for Appellee

No. 21097

In the

United States Court of Appeals
For the Ninth Circuit

UNITED PACIFIC INSURANCE CO.,

Appellant,

vs.

THE IDAHO FIRST NATIONAL BANK,

Appellee

THE IDAHO FIRST NATIONAL BANK,

Cross-Appellant,

vs.

UNITED PACIFIC INSURANCE CO.,

Cross-Appellee.

APPELLANT'S APPENDIX OF EXHIBITS

On Appeal from the District Court of the United States for the District of Idaho, Southern Division

FILED

NOV 23 1966

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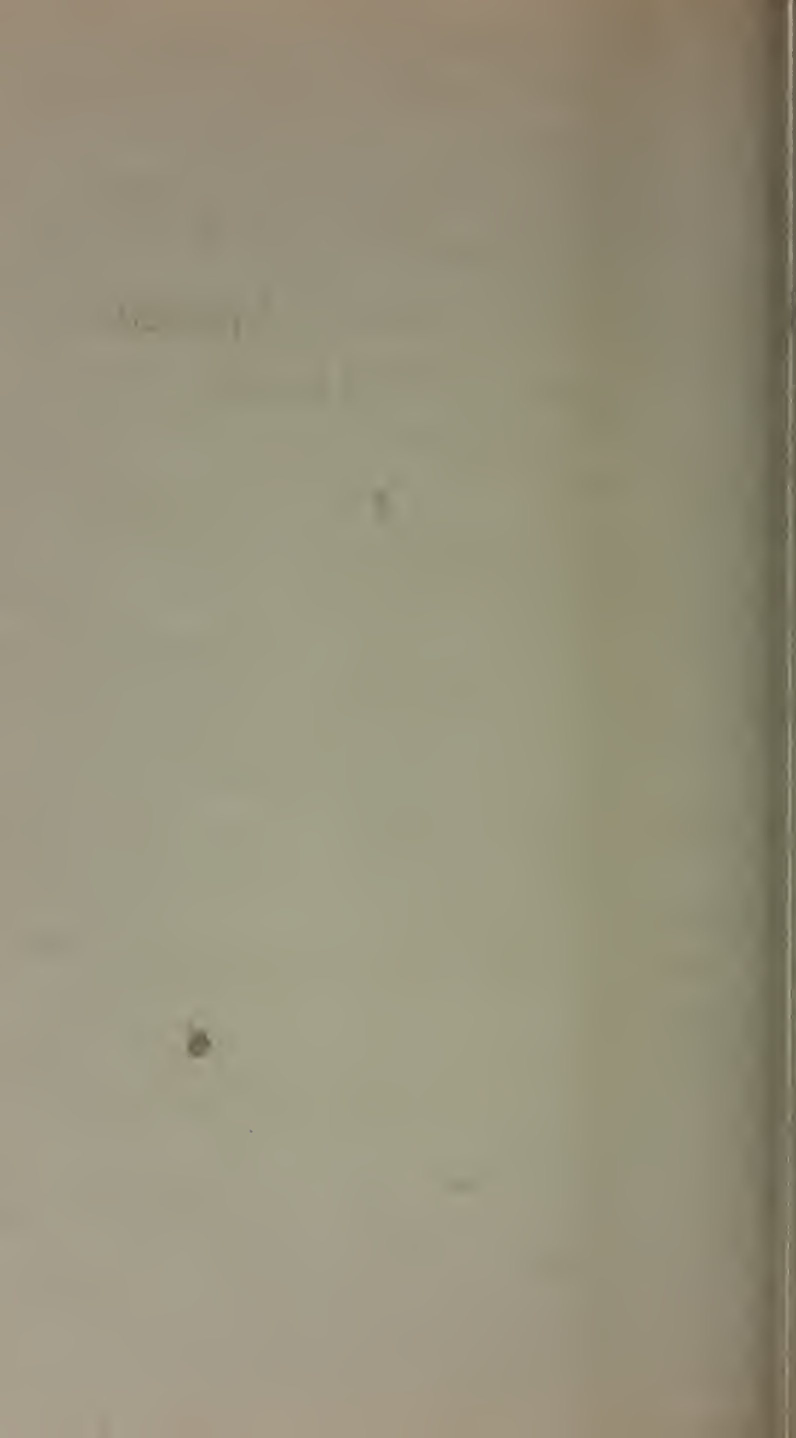

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APPELLANT'S APPENDIX OF EXHIBITS

Comes now the Appellant herein and requests the court to file herein Appellant's Appendix of Exhibits as follows:

APPENDIX OF EXHIBITS

Exhibit	Identified	Offered	Admitted or Rejected
Plaintiff's 1		Pre-Trial Order	
Plaintiff's 2	Vol. II, 2-A to 2-M	Vol. II, p. 16	Vol. II, p. 16
Plaintiff's 3		Vol. II, p. 17	Vol. II, p. 17
Plaintiff's 4		Pre-Trial Order	
Plaintiff's 4		Vol. III, p. 2	Vol. III, p. 2
Plaintiff's 5		Pre-Trial Order	
Defendant's 10	Vol. III, p. 38	Vol. III, p. 39	Vol. III, p. 39
Defendant's 11	Vol. III, p. 38	Vol. III, p. 39	Vol. III, p. 39
Defendant's 12	Vol. III, p. 42	Vol. III, p. 42	Vol. III, p. 48
Defendant's 13	Vol. III, p. 48	Vol. III, p. 48	Vol. III, p. 48
Defendant's 14	Vol. III, p. 48	Vol. III, p. 48	Vol. III, p. 48
Defendant's 15	Vol. III, p. 48	Vol. III, p. 48	Vol. III, p. 48
Plaintiff's 16	Vol. III, p. 47	Vol. III, p. 47	Vol. III, p. 48
Plaintiff's 17	Vol. III, p. 48	Vol. III, p. 48	Minute Entry Nov. 23, 1965 (Tr Vol. I, p. 78)

Respectfully submitted

CLEMONS, SKILES & GREEN

By ______________________________

Attorneys for Appellant

ACKNOWLEDGMENT OF SERVICE

The undersigned, attorneys of record for cross-appellant herein, hereby acknowledge receipt of three copies of the foregoing brief this ____ day of November, 1966.

LANGROISE, CLARK & SULLIVAN

By ______________________________

Attorneys for Cross-Appellants

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Cross-Appellee.

BRIEF OF APPELLEE

STATEMENT OF THE CASE

Appellent's statement of the facts leaves much to be desired. It is impossible to understand the basis of the trial court's decision without knowing all of the facts.

For many years prior to the commencement of this suit Gem Creamery Company was a business located in Emmett, Idaho, approximately thirty miles from

Boise. This company was engaged in the business of selling butter, eggs and produce (Tr. Vol. 2, p. 78). The farm products were procured from farmers and then sold through routes (Tr. Vol. 2, pp. 77-80). Cream that was picked up was processed into butter for resale. In January of 1962, the business was purchased by Dwayne Doramus and Floyd Worley (Tr. Vol. 2, p. 22). Their banking was done with the Emmett, Idaho, branch of the First Security Bank of Idaho. While a checking account was maintained, payment of obligations was made by the use of drafts payable at the First Security Bank in Emmett. Drafts came into that bank in the regular course of bank clearing and these were accumulated throughout each day. At approximately three o'clock each afternoon one of the principals in the business would go to the bank and write a check to cover the drafts that were to be honored. By that time of the day the bank would have run a tape on the drafts received that day. These daily checks to the bank were the only checks that were written on the checking account (Tr. Vol 2, pp.22-26).

The number of drafts increased drastically from January, 1962, to February, 1963. While in January, 1962, 170 Gem Creamery drafts went through the First Security Bank, in February of 1963, the number totaled 2,213. The buildup in the number of drafts was consistent through the period of fourteen months. For example, the number in August of 1962, was 1,649 (Tr. Vol. 2, pp. 26-29).

The dollar volume represented by the drafts increased accordingly. This volume is shown by Plaintiff's Exhibit 8. This exhibit shows the amount of each daily check written to the bank to cover drafts (Tr. Vol. 2, p. 29).

The increase in the number of drafts and in the amount of them was caused by something other than an increase in the business of Gem Creamery. From the middle of 1962 on employees were cashing drafts and returning the proceeds to the partners (Tr. Vol. 2, p. 72). Every few days employees were given from one to eight drafts and told to cash them and return the proceeds. Each draft would be made out in favor of the employee who was to cash it. The drafts would be cashed at banks, clothing stores and grocery stores, among other places. At grocery stores it was customary for an employee to purchase cigarettes or soft drinks. Any part of the proceeds that had been so spent had to be paid back to the partners along with the remainder of the proceeds (Tr. Vol. 2, pp. 72-74, 83-85).

Most, if not all, of the six to eight steady employees cashed drafts in this manner (Tr. Vol. 2, pp. 75, 85). The extent to which the employees were used for this purpose is illustrated by the fact that one of the former employees who testified to having cashed drafts in this manner every few days was primarily a butter-maker (Tr. Vol. 2, p. 77), and the other was a handyman and butter-cutter (Tr. Vol. 2, p. 83).

The bubble burst in late February of 1962. Drafts were first dishonored on February 25, 1963 (Tr. Vol. 2, p. 31). In all approximately 450 drafts were dishonored and returned unpaid during the period from February 25, 1963, to March 5, 1963 (Tr. Vol. 2, p. 33-35; Pl. Ex. 9). The dollar amount of these drafts was approximately $80,000. All but a few of the dishonored drafts were drawn payable to the order of an employee of Gem Creamery (Tr. Vol. 2, pp. 75-77).

Almost all of the dishonored drafts contained endorsements indicating they were cashed at department stores, grocery stores, drug stores or banks (Tr. Vol. 2, pp. 35-38; Pl. Ex. 9).

Appellee, The Idaho First National Bank, suffered a loss at its Broadway Office in Boise, Idaho, in the amount of $4,683.00 due to its having cashed drafts which were dishonored (Amended Finding of Fact XII; Tr. Vol. 1, p. 55; Pl. Exs. 2 and 2-2M). Fourteen drafts were involved, all of which were dated either February 19, or February 20, 1963. The only endorsement on each draft was that of the payee — in each case an employee of Gem Creamery (Pl. Exs. 2 and 2-2M; Tr. Vol. 2, pp. 75-77).

The same thing happened at another Boise office of appellee, its Capital Office. The loss there was $5,801.46 (Amended Finding of Fact XIII; Tr. Vol. 1, p. 55); twenty drafts were dishonored; the drafts contained dates of February 16, 18, 19, and 20, 1963; and only endorsements were those of the payee — in each case an employee of Gem Creamery (Pl. Exs. 3 and 3-3S; Tr. Vol. 2, pp. 75-77).

The facts leading up to the loss are the same in regard to both branches. Gem Creamery drafts were first cashed during the Fall of 1962 (Tr. Vol. 3, pp. 4, 13, 27, 28). At the Capital Office sixty to seventy-five had been cashed by one teller and they were all honored (Tr. Vol. 3, p. 4). Ninety to one hundred were cashed by one teller at the Broadway Office and they were all honored (Tr. Vol. 3, pp. 13, 14). The drafts were cashed by the payees and were endorsed in the presence of the tellers (Tr. Vol. 3, pp. 7, 14, 21, 27, 28).

As to the drafts which were dishonored, the procedure was the same. When drafts were taken which were later dishonored, the tellers handled them as cash items on the assumption that they were checks (Tr. Vol. 2, p. 97; Tr. Vol. 3, pp. 7, 8, 16, 17, 24, 27, 28). One reason for this is that the drafts were practically identical in form to checks (Pl. Exs. 2 and 2-2M; 3 and 3-3S).

While there is no evidence of any verbal representations having been made at the time of cashing the dishonored drafts, false representations were made at earlier times. There was one instance when a representation was made that a draft was in payment for dairy products (Tr. Vol. 3, p. 5). Twice representations were made at grocery stores that the drafts were paychecks (Tr. Vol. 2, pp. 51, 58).

Other businesses suffered in a manner similar to appellee. Managers of two grocery stores testified that drafts were cashed over a considerable period of time without a problem, and that a much greater number of drafts than normal were cashed in the week ending February 20, 1962, and that all of these were dishonored (Tr. Vol. 2, pp. 43-62). Another bank suffered losses at two of its branches, and the facts were similar to those involved in appellee's losses (Tr. Vol. 2, pp. 63-69).

By the time the affairs of Gem Creamery were settled in bankruptcy, the unsecured creditors received a return of 0.002784% on their claims (Tr. Vol. 2, p. 47).

SUMMARY OF ARGUMENT

Appellant's brief clearly states the contention of

appellee and the basis for the judgment by the trial court in appellee's favor — that there was a loss of property by reason of cashing the drafts and that the loss was one suffered through false pretenses.

There are two type of false pretenses present here. The entire operation of Gem Creamery, and particularly its method of using drafts, was a false pretence — one calculated to lull the public into cashing more and more drafts until the inevitable happened. In addition the cashing of the drafts was a representation that there were funds to honor them.

Appellant contends that forgery is involved. There is no basis for such contention.

ARGUMENT

I. *The Method of Operation Constituted a False Pretense.*

A substantial portion of the brief submitted by appellant concerns itself with the distinction between checks and drafts, and with the requirements for a criminal conviction for the crime of false pretenses. What appellant has neglected to do is to show in what respects the evidence does not support the specific findings of false pretenses made by the trial court.

In the Amended Findings of Fact and Conclusions of Law (Tr. Vol. 1, pp. 51-59) there are specific findings of all of the elements appellant contends must be present to constitute false pretenses. These specific findings are as follows:

XVI

"By the actions and deliberate course of conduct

of itself and its employees Gem Creamery Company impliedly represented to plaintiff statements of existing fact, to wit: that the drafts which were later dishonored were issued in the regular course of business, and that it had funds or credit for the payment of the drafts cashed by plaintiff which were later dishonored.

XVII

"Gem Creamery Company did not have funds or credit for the payment of the drafts cashed by plaintiff which were dishonored, and said drafts were not issued in the regular course of business.

XVIII

"Gem Creamery Company knew that the said implied representations were untrue and said misrepresentations were adapted to induce the plaintiff to part with money.

XIX

"Plaintiff relied on the the false representations of Gem Creamery Company and the loss was in fact caused by said false representations and false pretenses." (Tr. Vol. 1, pp. 6, 7)

Because of these findings, any distinctions between drafts and checks are only academic. The representations that the drafts were issued in the regular course of business and that there were funds or credits for the payment of them did not relate to future acts — they related to past and present representations.

The findings are supported by the evidence presented. The representations were implied from *all* of the actions of Gem Creamery and its employees. These actions include the use of drafts which closely resembled checks, the increase in the number of drafts cashed, and the large loss suffered by appellee and others. More importantly, every element of the scheme was intended to, and did, lull appellant into cashing the drafts until finally the two branch banks took thirty-four drafts within the period of a few days. This was explained to the trial court when appellant objected to the admission of testimony relating to the manner in which Gem Creamery dealt with the Emmett Branch of First Security Bank.

> "MR. FAUCHER: It is our contention that the entire method of doing business was in fact a false pretense calculated to misrepresent their ability to pay and to misrepresent their financial condition." (Tr. Vol. 2, p. 24)

After the submission of all the evidence and the consideration of it as a whole, the trial court agreed.

II. *The Cashing of the Drafts Constituted a False Pretense.*

The same findings of the elements of false pretenses can be supported in a slightly different manner. The presentment of the drafts was a representation that there were funds or credits for payment.

Since there are no cases based on bankers blanket bonds which involve false pretenses through drafts, it is necessary to consider the case law relative to dis-

honored checks and to proceed from there. Starting with *Hartford Accident & Indemnity Co. v. Federal Deposit Ins. Corp.*,204 F2d 933 (8th Cir. 1953) and *Fidelity and Casualty Company v. Bank of Altenburg*, 216 F2d 294 (8th Cir. 1954), the courts have uniformly held the insurance companies liable for loss caused by check-kiting on the basis that it constitutes false pretenses. The decisions invariably disclose that the type of bond involved was a Bankers Blanket Bond, Form 24, the same one issued by appellant to appellee in this instance. *Indemnity Insurance Co. v. Pioneer Valley Savings Bank*, 343 F2d 634 (8th Cir. 1965); *United States v. Western Contracting Corporation*, 341 F2d 383 (8th Cir. 1965); *Pioneer Valley Savings Bank v. Indemnity Insurance Co.*, 225 F. Supp. 404 (D.C. Iowa 1964).

Check-kiting in its simplest form is the drawing of a check on X bank and the cashing of it with Y bank, with the drawee then depositing the proceeds in X bank to cover the check when it comes through. Y bank can be lulled into cashing larger and larger checks by the fact that they are always honored by X bank. On the other hand it can involve accounts in two different banks, as was the case in the Brazeau-Altenburg loss. *Hartford Accident & Indemnity Co. v. Federal Deposit Ins. Corp., supra*, and *Fidelity and Casualty Company v. Bank of Altenburg, supra.*

Appellant's contention that the instruments constituted promises to pay in the future instead of representations of existing fact is neither new nor novel. It was also raised in some of the check-kiting cases. In *Fidelity and Casualty Company v. Bank of Altenburg, supra*, the contention was made by the insurance company and the Court of Appeals rejected it.

> "Defendant says that Schneier's representation to plaintiff bank was in effect that the checks he deposited with it drawn on the Brazeau Bank would be paid when presented to that bank. It says that was a representation of a promissory nature of a future, not an existing fact. But that is not the manner in which the plaintiff's officials construed Schneier's conduct in presenting the checks to it for deposit. The representation implied was that sufficient funds were on deposit to meet the checks. That was a representation of a present existing fact." 216 F2d at 301.

Likewise, after the District Court had ordered dismissal of a suit brought under the "false pretenses" clause of a bond on the ground that the taking of a check involved no representation, the Court of Appeals in *United States v. Western Contracting Corporation*, 341 F2d 383 (8th Cir. 1965), reversed, holding that the requisite misrepresentation was present. According to the stipulated facts (341 F2d at 386), there is no indication that any written or verbal representations were made — the wrongdoer merely deposited checks in his account with the bank and was allowed to draw against the deposits prior to collection. This in itself brought the loss within the policy definition of "false pretenses."

> "There can be no question that the giving of the checks constituted a representation that the checks were good. Such representation was relied upon by the Bank in permitting H. K. to draw on uncollected funds . . . The loss resulted from the false pretenses . . . We are satisfied that the transactions fall within the false pretense coverage of the blanket bond executed by Globe." 341 F2d at 390.

Among the additional cases supporting the proposition that the giving of a worthless check constitutes false pretenses are *Pioneer Valley Savings Bank v. Indemnity Insurance Co., supra,* affirmed in *Indemnity Insurance Co. v. Pioneer Valley Savings Bank, supra,* and *Landwehr v. United States,* 304 F2d 217 (8th Cir. 1962), which affirmed a conviction for transporting a stolen motor vehicle in interstate commerce. In this last cited case the government had contended that the writing and tendering of a check was itself a representation that there were sufficient funds in the account and that it would be paid. The District Court and the Court of Appeals agreed with the contention.

As shown particularly by *Fidelity and Casualty Company v. Bank of Altenburg, supra,* and *United States v. Western Contracting Corporation, supra,* the important factor is the manner in which the bank considered the instruments. In these two cited cases the checks were deposited for credit and then drawn against, and still the implied representation was held to be present because the banks construed the actions of the depositors to mean that funds were on hand to honor the checks. In the instant case there is even more evidence of the implied represenation than in those cases. Here the drafts were treated as cash items and cash was given to the payees. Here there was no crediting to an account which could later be charged back if the instruments proved to be uncollectible.

If, as the cases indicate, the manner in which the instruments are considered and handled by the bank is the determinative factor, there is no reason to distinguish between drafts and checks. Appellant has contended that there is a technical distinction between

checks and other types of bills. This is true, and there are probably occasions when the distinction is important. Here it is not.

There are various types of drafts, and they are used for different purposes. A sight draft or a time draft is often used in connection with goods shipped under a negotiable bill of lading. The purchaser or his bank can accept the draft after all credit arrangements have been made and after the goods have been examined. On the other hand, large casualty insurance companies use drafts in payment of claims and these circulate and are accepted as readily as any checks. The appellant here uses such drafts. Presumably the reason why drafts are used for this purpose is that it gives the insurance company the opportunity to carefully examine the back of the instrument where the releases of further liability are contained.

There is no magic in a check. Unless it is certified by the drawee bank, payment can be stopped by the drawer at any time prior to presentment, and the drawer can withdraw the funds while the check is enroute to the bank. From the viewpoint of the person cashing an instrument there is no distinction between the type of drafts involved here and uncertified checks. A lack of funds in back of them will cause a loss. In one case inaction (failure to honor) and in the other case action (stopping payment or withdrawal) will cause a loss. Appellee treated the drafts here as cash items—the same way that checks would have been treated. The course of conduct that had existed between appellee and Gem Creamery caused appellee to rely on the implied representation that funds or credits were available to honor them.

In all of the federal civil cases thus far cited the question of whether or not criminal statutes are controlling has been raised. This is important here because most, if not all, of the cases cited by appellant are criminal cases. In most of these cases the courts were able to bypass the issue. Likewise in the instant case it will be shown later that the crime was committed under the provisions of Idaho law. However, the proposition that the requisites necessary for conviction need not be proven is supported by *Pioneer Valley Savings Bank v. Indemnity Insurance Co., supra,* where the court, in addition to citing other cases, said that strong support is made for the proposition in *Fidelity and Casualty Company v. Bank of Altenburg, supra.*

Moving to the Idaho criminal statutes, several cases support the proposition that the making or passing of worthless checks constitutes the crime of false pretenses.

State v. Roderick, 375 P2d 1005, 85 Idaho 80 (1962);

State v. Davis, 336 P2d 692, 81 Idaho 61 (1959);

State v. Larsen, 286 P2d 646, 76 Idaho 528 (1955);

*State v. Campbell,*219 P2d 956, 70 Idaho 408 (1950).

Two of the cases, *State v. Roderick, supra,* and *State v. Campbell, supra,* stand for the proposition that the only distinction between *Idaho Code* Sec. 18-3101 (which provides that false pretenses is a felony) and Sec. 18-3106 which concerns drawing and passing instruments and also provides for prima facie evidence)

is that Sec. 18-3101 may only be used where ". . . the accused *obtained* money or property by means of false pretenses." (emphasis added) 375 P2d at 1007. On the other hand a person can be convicted of a violation of Sec. 18-3106 even if the making or passing of the instrument does not result in the accused having obtained anything. *State v. Campbell, supra.*

Idaho Code Sec. 18-3106 is set out in the Appendix together with other applicable Idaho statutes. In part that section provides that "As against the maker or drawer thereof, the making, drawing, uttering or delivering of such check, draft or order as aforesaid shall be prima facie evidence of intent to defraud and of knowledge of no funds or insufficient funds, as the case may be, in or credit with such bank, or depositary, or person, or firm, or corporation, for the payment in full of such check, draft or order upon its presentation." In *State v. Davis, supra,* and in *State v. Larsen, supra,* the Idaho Supreme Court approved instructions which applied the prima facie evidence of Sec. 18-3106 to prosecution for violations of Sec. 18-3101.

> "Where as in this case a worthless check is issued as the false token to accomplish the fraudulent purpose, such instruction is proper. Sec. 18-3106, I.C.; State v. Larsen, 76 Idaho 528, 286 P2d646. " 336 P2d at 695.

Some explanation of the prima facie provision is contained in *State v. Campbell, supra.* There the defendant contended that since both intent to defraud and knowledge of the non-existence of sufficient funds or credit are presumed there is a presumption based on a presumption. The court answered by saying, "The

statute in question does not base a presumption upon a presumption but provides for two separate presumptions based upon the fact of the making or uttering of the check without funds or credit for its payment." 219 P2d at 959.

The Idaho Supreme Court is not alone in applying such a statute and its provisions to a false pretense situation. It has been done by federal courts in suits brought to recover losses alleged to have been caused by false pretenses under the provisions of bankers blanket bonds. In *Indemnity Insurance Co. v. Pioneer Valley Savings Bank, supra,* and *Pioneer Valley Savings Bank v. Indemnity Insurance Co., supra,* Section 28-1213 of the Iowa Code (the equivalent of *Idaho Code* Sec. 18-3106) was involved. In *United States v. Western Contracting Corporation, supra,* two sections of Nebraska law were involved. Section 28-1213 was equivalent to the first part of *Idaho Code* Sec. 18-3106, while Section 28-1241 contained the presumptions which are stated in the Idaho statute. Not only did the Court of Appeals apply the two statutes to the claim for recovery under the bond, but it emphatically stated that the presumptions controlled.

> "The record conclusively shows that $55,000 in H. K. checks deposited in plaintiff's bank were dishonored for lack of funds. Proof of presentment for payment, nonpayment, and protest is uncontested. Under Sec. 28-1214 the nonpayment of such checks created a rebuttable presumption of intent to defraud and knowledge of insufficient funds or credit in such bank. We find in the record no substantial evidence to rebut the presumption . . .
>
> "There can be no question that the giving of the

checks constituted a representation that the checks were good. Such representation was relied upon by the Bank in permitting H. K. to draw on uncollected funds. The unrebutted presumption of Sec. 28-1214 establishes evidence of intent to defraud and knowledge of insufficient funds or credit to take care of the checks. The loss resulted from the false pretense. The basic error committed by the trial court on this ground is its failure to give recognition to the rebuttable presumption created by Sec. 28-1214. We are satisfied that the transactions fall within the false pretense coverage of the blanket bond executed by Globe." 341 F2d at 389, 390.

The Idaho statute, Sec. 18-3106, is not limited to checks. It specifically applies to drafts. There can be no question but what a draft whether drawn on another person or on the drawer itself, is treated exactly the same as a check.

Inferentially, one of the Idaho cases can also be used to show that the future presentment aspect of a draft does not mitigate against such an instrument being the basis for a false pretense action. In *State v. Larsen, supra*, the defendant was convicted of the crime of false pretenses (Sec. 18-3601) based on his passing a post dated check.

"If, as appellant contends, it was post dated one day, he did not direct attention to such fact nor ask the payee to hold the check, or otherwise in any manner indicate that the check was not a valid order for the immediate payment of money. It was given and accepted as a valid order for the present payment of $2,000. The appellant knew he had no funds or

credit in the drawee bank at the time the check was delivered, nor thereafter." 286 P2d at 647.

While on the subject of Idaho law, one more observation can be made concerning the lack of difference between checks and drafts. The Uniform Negotiable Instruments Law (Idaho Code Sec. 27-101 et seq.) contains no provision which differentiates a check from any other type of draft or bill.

III. *The Drafts Are Not Forgeries.*

Appellant has made an attempt to convince the court that forgery is involved here. The substance of the argument is that the drafts were false instruments because they were not honored.

The cases cited in support of the argument have nothing in common with this factual situation. *Ex Parte Hibbs*, 26 Fed. 421 (D.C. Ore. 1886), involved the age-old problem of the ficticious payee. Hibbs, a postmaster, advised the government that certain money orders had been purchased by person who did not exist. Hibbs then indorsed the money orders in the names of the ficticious payees. In the instant case there were no ficticious payees and there is no evidence even hinting that the names contained on the front and back of the drafts were other than the signatures of the persons who purported to sign them.

Also cited is *Peoples Bank & Trust Co. v. Fidelity & Casualty Co.*, 57 SE2d 809, 231 N.C. 510, 15 ALR2d 996 (1950). There a man who did not have an account at the bank discovered that his signature would pass for that of another man who did have an account at

that bank. The situation here is not the least bit analogous. Here there was no attempt to have the instruments pass for those of another party, and no attempt to have a signature pass for that of someone else.

There are cases which have become before the courts wherein the contention has been made that invoices listing non-existent sales are forgeries. Such a contention is certainly more logical than appellant's. Even there, however, the rule of law is that there is no forgery as that term is used in a bankers blanket bond.

> *First National Bank of South Carolina v. Glens Falls Ins. Co.*, 304 F2d 866 (1962);
>
> *State Bank of Poplar Bluff v. Maryland Casualty Co.*, 289 F2d 544 (8th Cir. 1961);
>
> *Pasadena Investment Co. v. Peerless Casualty Co.*, 282 P2d 124, 132 Cal. App.2d 328 (1955).

For definitions of "forgery" as the term is used in bankers blanket bonds and for the citation of cases holding certain acts not to constitute forgery, appellee refers the court to Brief of Cross-Appellant submitted by appellee herin in connection with the cross-appeal from this action (Brief of Cross-Appellant, pp. 12, 13).

At the trial of this action no evidence was offered questioning the validity of any signatures, nor was any offered questioning the authority of any person to sign. The burden was on the insurance company (appellant) to prove than an exclusion in the policy allowed it to avoid liability. *O'Neil v. New York Life Ins. Co.*, 152 P2d 707, 65 Idaho 722 (1944).

CONCLUSION

Appellee respectfully requests that the judgment granted in its favor be affirmed. It is supported by the evidence presented and by the applicable law.

Respectfully submitted,

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LANGROISE, CLARK & SULLIVAN
Attorneys for Appellee

CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit and that, in my opinion, the foregoing brief is in full compliance with those rules.

J. Dennis Faucher, Attorney

ACKNOWLEDGEMENT OF SERVICE

The undersigned, attorneys of record for appellant herein, hereby acknowledge receipt of three copies of the foregoing brief this ____ day of November, 1966.

CLEMONS, SKILES & GREEN

By ______________________________
Attorneys for Appellant

APPENDIX

Idaho Code, Section 18-3101. Every person who knowingly and designedly by any false or fraudulent representation or pretense, defrauds any other person of money, labor or property, whether real or personal, or obtains the signature of another to any instrument in writing whereby any liability is created, or who causes or procures others to report falsely of his wealth or mercantile character, and by thus imposing upon any person obtains credit, and thereby fraudulently get possession of money or property, or obtains the labor or service of another, is punishable in the same manner and to the same extent as for larceny of the money or the value of the property so obtained; and the reasonable value of any labor or services and the amount of the liability created by any written instrument shall be taken as the value of such labor or services or of such written instrument.

Idaho Code, Section 18-3106. (a) Any person who for himself or as the agent or representative of another or as an officer of a corporation, wilfully, with intent to defraud shall make or draw or utter or deliver, or cause to be made, drawn, uttered, or delivered, any check, draft or order for the payment of money upon any bank or depositary, or person, or firm, or corporation, knowing at the time of such making, drawing, uttering or delivery that the maker or drawer has no funds in or credit with such bank or depositary, or person, or firm, or corporation, for the payment in full of such check, draft or order upon its presentation, although no express representation is made with reference thereto, shall upon conviction be punished by imprisonment in the state prison for a term not to

exceed three years or by a fine not to exceed $5,000.00 or by both such fine and imprisonment.

(b) Any person who for himself or as the agent or representative of another or as an officer of a corporation, wilfully, with intent to defraud shall make, draw, utter or deliver, or cause to be made, drawn, uttered or delivered, any check, draft or order for the payment of money in the sum of $25.00 or more, upon any bank or depositary, or person, or firm, or corporation, knowing at the time of such making, drawing, uttering or delivery that the maker or drawer has some but not sufficient funds in or credit with such bank or depositary, or person, or firm, or corporation, for the full payment of such check, draft or order upon its presentation, although no express representation is made with reference thereto, shall upon conviction be punished by imprisonment in the state prison for a term not to exceed three years, or by a fine not to exceed $5,000.00, or by both such fine and imprisonment.

(c) Any person who for himself or as the agent or representative of another or as an officer of a corporation, wilfully, with intent to defraud, shall make, draw, utter or deliver, or cause to be made, drawn, uttered, or delivered, any check, draft or order for payment of money, in a sum less than $25.00 upon any bank or depositary, or person, or firm, or corporation, knowing at the time of such making, drawing, uttering or delivery that the maker or drawer has some but not sufficient funds in or credit with such bank or depositary, or firm, or person, or corporation, for the full payment of such check, draft or order upon its presentation, although no express representation is made with reference thereto, shall upon conviction for a first

offense be punished by imprisonment in the county jail for a term not exceeding six months, or by a fine not exceeding $300.00 or by both such fine and imprisonment; and upon a second conviction the person so convicted shall be punished by imprisonment in the county jail for a term not exceeding one year, or by a fine not exceeding $1,000.00, or by both such fine and imprisonment; provided, however, that upon a third or subsequent conviction, the person so convicted shall be punished by imprisonment in the state prison for a term not exceeding three years, or by a fine not exceeding $5,000.00, or by both such fine and imprisonment.

(d) As against the maker or drawer thereof, the making, drawing, uttering or delivering of such check, draft or order as aforesaid shall be prima facie evidence of intent to defraud and of knowledge of no funds or insufficient funds, as the case maye be, in or credit with such bank, or depositary, or person, or firm, or corporation, for the payment in full of such check, draft or order upon its presentation. The word "credit" as used herein shall be construed to mean an arrangement or understanding with the bank or depositary, or person, or firm, or corporation upon whom such check, draft or order is drawn for the payment of such check, draft or order.

No. 21097

In the

United States Court of Appeals For the Ninth Circuit

UNITED PACIFIC INSURANCE CO.,

Appellant,

vs.

THE IDAHO FIRST NATIONAL BANK,

Appellee

THE IDAHO FIRST NATIONAL BANK,

Cross-Appellant,

vs.

UNITED PACIFIC INSURANCE CO.,

Cross-Appellee.

BRIEF OF CROSS-APPELLANT

On Appeal from the District Court of the United States for the District of Idaho, Southern Division

FILED

NOV 4 1966

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Cross-Appellee.

BRIEF OF CROSS-APPELLANT

JURISDICTION

Jurisdiction is based on diversity of citizenship and the fact that the amount in controversy is in excess of $10,000.00. Cross-appellant is a national banking association with its principal place of business in Boise, Idaho. Cross-appellee is a corporation organized and existing under the laws of the State of Washington with its principal place of business in that state and

is licensed to do an insurance business in the State of Idaho. There matters are admitted in the Pre-Trial Order (Tr. Vol. I, p. 32).

The basis of jurisdiction of the United States District Court to hear this cause is based upon 28 U.S.C. Sec. 1332. The jurisdiction of this court to review is based upon 28 U.S.C. Sec. 1291.

STATEMENT OF THE CASE

Cross-appellant brought this action in the United States District Court to recover for two losses which it had suffered during the course of banking operations. The District Court ruled adversely to cross-appellant on Counts II and III of the complaint and in cross-appellant's favor on Count I. Only one transaction is involved in this cross-appeal, although two counts of the complaint, Count II and Count III, are involved. This cross-appeal followed judgment being entered on Counts II and III in favor of cross-appellee.

To a great extent cross-appellant is in agreement with the Amended Findings of Fact by the trial court. Since these have not been contested by cross-appellee, they can be used to show most of the factual situation. These Findings include the following (Tr. Vol. I, pp. 51-59):

1. Cross-appellee issued to cross-appellant its Bankers Blanket Bond, Form No. 24, and this bond remained in full force and effect at all times pertinent here;

2. On February 10, 1964, a woman giving her name as Clara Perkins deposited with cross-appellant at its Lewiston, Idaho, branch a check which purported to be a cashier's check drawn on and issued by the First National Bank of San Angelo, Texas;

3. The purported cashier's check was not a form of cashier's check used by that bank, and was instead a counter check which had been changed in appearance to make it appear to be a cashier's check;

4. The name which appeared to be that of an authorized signatory, James C. Bolton, was not the name of any person who had ever been an officer or employee of the First National Bank of San Angelo, Texas;

5. On account of the transaction cross-appellant suffered a loss in the amount of $2,987.35.

There are other pertinent facts. The Bankers Blanket Bond (Pl. Ex. 4) covered not only loss through a counterfeit instrument or signature, insuring clause (E), but also loss through false pretenses, insuring clause (B).

When the woman first made herself known in the branch bank in the early part of February of 1964, she opened a checking account with a small deposit and represented that her husband had been transferred from Boise to Lewiston as an agent with the Internal Revenue Service (Tr. Vol. III, p. 31). At that time she gave the bank a local address (Tr. Vol. III, p. 32). Between that first encounter and the cashing of the purported cashier's check a week or more elapsed. During that period of time she went into the bank twice — once to return the signature cards and once to cash a check (Tr. Vol. III, p. 32). At the time she presented the purported cashier's check (Pl. Ex. 1), she represented that the check constituted proceeds from the sale of a house that had belonged to her deceased father in Texas (Tr. Vol. III, p. 34). She asked for and received $3,000 in cash, stating that she needed

that amount to apply on the purchase of a home (Tr. Vol. III, p. 34).

The bank later discovered that the Internal Revenue Service had no agent by the name the woman gave as that of her husband and that, while she had rented an apartment at the address given, she had not established residence there (Tr. Vol. III, pp. 34, 35). The check was not honored, as the Amended Findings of Fact show.

SPECIFICATIONS OF ERROR

Cross-appellant contends the court erred in the following:

1. In not finding in it favor on Count II of the Complaint.

2. In not finding in its favor on Count III of the Complaint.

3. In not entering Judgment in its favor and against cross-appellee on Count II of the Complaint.

4. In not entering Judgment in its favor and against cross-appellee on Count III of the Complaint.

5. In making and entering that portion of its Finding of Fact Number V under the heading Counts II and III which reads as follows: ". . . and was in fact a forgery."

6. In making and entering its Conclusion of Law Number II under the heading Counts II and III.

7. In not making and entering under the heading Counts II and III its finding of fact that the loss was caused by false pretenses.

8. In not making and entering under the heading Counts II and III its finding of fact that the loss was caused by counterfeiting or conterfeit instrument.

9. In not making and entering a conclusion of law that it is entitled to judgment against cross-appellant under Count II and/or III for the sum of $2,987.35 plus reasonable attorney fees and costs, and for interest on said sums from and after the date of judgment at the rate of 6% per annum.

SUMMARY OF ARGUMENT

The loss sustained was covered by two separate insuring clauses of the Bankers Blanket Bond. It was a loss through the insured's having given value upon a written instrument which was counterfeited, and it was a loss through false pretenses.

While a loss through false pretenses is excluded if it is effected by means of forgery, the exclusion is inapplicable because forgery was not present. In regard to the loss being based on a counterfeit instrument, there is no general exclusion for forgery, but there is an exclusion contained within the applicable insuring clause. This limited exclusion does not apply to the factual situation present here.

ARGUMENT

I. *The Bond and Applicable Law — In General*

To a great extent this cross-appeal calls for the construction of the insurance policy involved — the Bankers Blanket Bond, Form No. 24. Only a few provisions are applicable, and these are insuring clauses (B) and (E), and exclusion 1(a). These provisions are as follows:

(B) Any loss of Property through robbery, burglary, commonlaw or statutory larceny, theft, false pretenses, hold-up, misplacement, mysterious unexplainable disappearance, damage thereto or destruction thereof, whether effected with or without violence or with or without negligence on the part of any of the Employees, and any loss of subscription, conversion, redemption or deposit privileges through the misplacement or loss of Property, while the Property is (or is supposed to be) lodged or deposited within any offices or premises located anywhere, except in an office hereinafter excluded or in the mail or with a carrier for hire, other than an armored motor vehicle company, for the purpose of transportation.

Any loss, through any hazard specified in the preceeding paragraph, of any of the items of property enumerated in the paragraph defining Property, while within any of the Insured's offices covered hereunder and in the possession of any customer of the Insured or of any representative of such customer, whether or not the Insured is legally liable for the loss thereof, excluding, however, loss caused by such customer or any representative of such customer.

(E) Any loss through the Insured's having, in good faith and in the course of business, whether for its own account or for the account of others, in any representative, fiduciary, agency or any other capacity, either gratuitously or otherwise, purchased or otherwise acquired, accepted or received, or sold or delivered, or given any value, extended any credit or assumed any liability, on the faith of, or otherwise acted upon any securities, documents or other

written instruments which prove to have been counterfeited or forged as to the signature of any maker, drawer, issuer, endorser, assignor, lessee, transfer agent or registrar, acceptor, surety or guarantor or as to the signature of any person signing in any other capacity, or raised or otherwise altered or lost or stolen, or through the Insured's having, in good faith and in the course of business, guaranteed in writing or witnessed any signatures, whether for valuable consideration or not and whether or not such guaranteeing or witnessing is ultra vires the Insured, upon any transfers, assignments, bills of sale, powers of attorney, guarantees, endorsements or other documents upon or in connection with any securities, obligations or other written instruments and which pass or purport to pass title to such securities, obligations or other written instruments; EXCLUDING, HOWEVER, any loss through FORGERY OR ALTERATIONS of, on or in any checks drafts, acceptances, withdrawl orders or receipts for the withdrawal of funds or Property, certificates of deposit, letters of credit, warrants, money orders or orders upon public treasuries; and excluding, further, any loss specified in subdivisions (1) and (2) of Insuring Clause (D) as printed in this bond, whether or not any amount of insurance is applicable under this bond to Insuring Clause (D).

Mechanically reproduced facsimile signatures are treated the same as handwritten signatures.

Section 1. This Bond Does Not Cover:

(a) Any loss effected directly or indirectly by means of forgery, except when covered by Insuring Clause (A), (D), (E), (F) or (G).

It will be noticed that exclusion 1(a) does exclude loss effected through false pretenses, insuring clause (B), when it is effected by means of forgery, unless the loss is covered by one of the other insuring clauses there enumerated.

It will also be noticed that if the loss is covered by insuring clause (E), the exclusion 1(a) is, by its own terms, inapplicable. Insuring clause (E) does have its own exclusionary provision.

Since this action is based on an insuring instrument, it might be well to consider several rules of construction relative to such contracts. They may be set out as follows:

Ambiguities are to be construed against the insurer and in favor of the insured.

> *Indemnity Insurance Co. v. Pioneer Valley Savings Bank*, 343 F2d 634 (8th Cir. 1965);
> *Hawkeye Casualty Co. v. Western Underwriter's Ass'n.*, 53 F.Supp. 256 (D.C. Idaho, 1944);
> *Mayflower Insurance Exchange v. Kosteriva*, 367 P2d 572, 84 Idaho 25 (1961);
> *Scharbach v. Continental Casualty Company*, 366 P2d 826, 83 Idaho 589 (1961).

Where a term in an insurance policy is susceptible of two constructions, the one most favorable to the insured will be adopted.

> *Nichols & Thompson Core Drill Co. v. Homeland Ins. Co.*, 148 F.Supp. 260 (D.C. Idaho 1957);
> *Scharbach v. Continental Casualty Co., supra*;
> *Penrose v. Commercial Travelers Insurance Company*, 275 P2d 969, 75 Idaho 524, (1954);

O'Neil v. New York Life Ins. Co., 152 P2d 707, 65 Idaho 722 (1944).

Where a clause in an insurance policy is susceptible of more than one construction, that construction most favorable to the insured will be adopted, and the policy will be construed in view of its general objects and conditions rather than with a strict and technical interpretation.

Penrose v. Commercial Travelers Insurance Company, supra; *O'Neil v. New York Life Ins. Co., supra*;
Rollefson v. Lutheran Brotherhood, 132 P2d 758, 64 Idaho 331 (1942).

In New York courts have twice held that the rule of construing ambiguities and clauses susceptible of more than one meaning against the insurer applies to bankers blanket bonds.

Kean v. Maryland Casualty Co., 223 NYS 373 (1927), affirmed 162 N.E. 514;
De Lanoy, Kipp & Swan v. New Amsterdam Casualty Co., 11 NYS2d 625 (1939).

II. *The Loss Was Caused by a Counterfeit Instrument and Is Not Excluded.*

Assuming that the loss is covered by insuring clause (E), the general exclusion 1(a) is not applicable. The wording of 1(a) is to the effect that forgery is not covered unless the loss is covered by insuring clause (E) or one of the other clauses there inumerated. Insuring clause (E) covers loss caused by the insured having "purchased or otherwise acquired . . . or given any value . . . upon . . . written instruments which prove to have been counterfeited . . ." The specific

manner in which this clause is to be interpreted was considered by the Court in *Fidelity Trust Co. v. American Surety Co. of New York*, 268 F2d 805 (3rd Cir. 1959). The court held that "forged" and "counterfeited" do not mean the same thing.

> "Argument for the surety companies urges the point that the word 'or' between the word 'counterfeited' and the word 'forged' indicates the use of different terms to express the same thing. That means, necessarily, that the word 'counterfeited' could just as well be left out for it adds nothing to the term 'forged.'
>
> "We do not think this is the best construction of the instrument. The form was offered as a contract by large professional surety companies who certainly know what they are doing. We cannot think that it has not been very carefully drafted or that the draftsman put in words to mean nothing. Furthermore, this language is that of the promisor who is doing professional business for a consideration. The bond contained in the record is a printed form submitted by the surety company. If there is doubt about the meaning of language under those circumstances, it is not to be resolved in favor of the one who chose the words and as a business transaction issued the bond to another. Its very term 'Blanket Bond' indicates that its coverage is to be wide and it is not unfair to interpret the document in this fashion.
>
> "The plaintiff's argument provides us with an ingenious diagram to show the type of loss which, under its construction, the bond protects against. It argues as follows:

'Plaintiff is protected against loss from its having acted upon "written instruments which prove to have been counterfeited or forged as to the signature of any maker, drawer, issuer, endorser, assignor, lessee, transfer agent or registrar, acceptor, surety or guarantor or as to the signature of any presons signing in any other capacity,

or raised

or otherwise altered

or lost

or stolen * * *" '

"We think that this is a more apt reading of the language than that shown in the argument of the defendant." 268 F2d at 807.

Three elements must be present before the loss comes within the clause as it was interpreted by the Court of Appeals — (1) the bank must have acted; (2) there must have been a written instrument; (3) the instrument must have been counterfeited. There can be no question but what the first two are present. The check (Pl. Ex. 1) is certainly a written instrument, and the bank certainly acted upon it when it was taken as a cash item. Whether or not the instrument was a counterfeit can best be considered in connection with the question of whether or not it was a forgery.

Even though the general exclusion for forgery does not apply, there is an exclusion within insuring clause (E). Excluded is any loss ". . . through FORGERY . . . of, on or in any checks . . ." Throughout the proceedings it has been the contention of the insurance company that the instrument was a forgery rather than a counterfeit instrument. The trial court held it to be a forgery.

That there is a distinction between the two was clearly stated by the Eight Circuit Court of Appeals in *Fidelity Trust Co. v. American Surety Co. of New York, supra.* If a counterfeit instrument is to be considered a forgery, then insuring clause (E) does not insure against any loss whatsoever. Logic dictates that a complex insuring clause is not inserted into a policy merely to exercise the minds of judges and lawyers.

It thus becomes a matter of choosing definitions of the two words and applying these to the facts. Obviously the definitions that should be considered are those prescribed by the courts in construing the exact clause present here and in construing similar clauses.

In *State Bank of Poplar Bluff v. Maryland Casualty Co.*, 289 F2d 544 (8th Cir. 1961) the court was called upon to define the terms. While the problem concerned chattel mortgages listing non-existent automobiles, the applicable clause was (E) of a Bankers Blanket Bond No. 24.

> "General definitions tell us that 'forgery' means the 'act of forging, fabricating, or producing falsely', that the noun 'counterfeit' means 'that which is made in imitation of something with a view to deceive', and that the verb 'counterfeit' means 'to imitate'. Webster's New International Dictionary (Second Edition, 1960). The legal definitions place like emphasis, so far as forgery is concerned, upon copying or imitating. Black's Law Dictionary (Fourth Edition, 1961); 23 Am.Jur., Forgery, Sec. 2; 37 C.J.S. Forgery Sec. 1; 14 Am.Jur., Counterfeiting, Sec. 2; 20 C.J.S. Counterfeiting Sec. 1. All this implies to us falsification and lack of genuineness in the instrument itself rather than in its content." 289 F2d at 547, 548.

In *Detroit v. Standard Accident Ins. Co.*, 222 N.W. 134, 245 Mich. 14 (1928), the insured sought to recover under a provision insuring against loss caused by forged indorsements. The facts disclosed that a valid check payable to a corporation had been indorsed in the name of the corporation "By J. P. Lynch." Lynch deposited the money to his own account and later withdrew it. The court held there has been no "forgery" if a person signs his own name pretending to represent one whom he does not in fact represent. Likewise in another bankers bond case, *Tiarks v. First National Bank of Mobile*, 182 So2d 366, ___ Ala. ___ (1966), the court held it is not forgery for one to sign his own name.

Applying the facts present here to the last cited cases, there is no forgery present. There is no evidence in the record indicating that the name which appeared on the instrument (James C. Bolton) was not in fact the name of the person who affixed that signature. Likewise there is no evidence indicating that the woman who indorsed was not in fact Clara Perkins. The burden was on the insurer to prove the signatures were not genuine — to prove that the loss was excluded. *O'Neil v. New York Life Ins. Co., supra*

Now using the definition of the two terms approved by the Eighth Circuit Court of Appeals in *State Bank of Poplar Bluff v. Maryland Casualty Co., supra*, the instrument is counterfeit, but is not a forgery. When additional typing or printing was put on the counter check so as to make it appear to be a cashier's check, this was making "in imitation of something with a view to deceive." It was the act of "copying or imitating." Since the signatures must be assumed to be genuine, there was "falsification and lack of genuine-

ness in the instrument itself rather than in its content."

Further support for cross-appellant's contentions is found in two cases which define "counterfeit" as used in insuring clause (E) to mean an imitation which simulates another document or writing.

> *Exchange National Bank of Orleans v. Insurance Co. of North America*, 341 F2d 673 (2nd Cir. 1965);
>
> *First National Bank & Trust Co. of Oklahoma City v. United States Fidelity & Guaranty Co.*, 347 F2d 945 (10th Cir. 1965).

III. *The Loss Was Caused By False Pretenses and Is Not Excluded.*

Several instances of false pretense are present in this case. The uncontroverted testimony of a bank employee, Gary Asker, clearly shows that the loss was caused by a scheme which was intended to lull the bank so that the check could be passed. All of the actions of the woman amounted to one gigantic false pretense. In addition there are specific instances of false pretenses. The woman falsely represented that her husband was an Internal Revenue agent who had recently been transferred to Lewiston; she represented that she had taken up residence at a specific address in Lewiston; and she represented that the check constituted the proceeds of the sale of her deceased father's house. Perhaps an even more glaring false pretense was the presenting of the check. The presenting itself was a representation that the instrument was valid.

Rather than explore the law relative to false pretenses, cross-appellant refers the court to the discussion and citation of authority in its brief submitted in the initial appeal arising from this action. The briefs of the appellant (cross-appellee herein) also concern themselves with the question of what constitutes false pretenses.

Once the presence of false pretenses is established, the burden of proving that an exclusion in the policy precludes recovery rests with the insurance company. *O'Neil v. New York Life Ins. Co., supra.* Since no evidence was presented by the insurance company (cross-appellee) at the trial of this action, the judgment in favor of the insurance company can only be based on the check itself (Pl. Ex. 1) and the wording of the bond (Pl. Ex. 4).

Since exclusion 1(a) excludes loss effected directly or indirectly by means of forgery, the only question is whether the loss was caused by forgery.

Once again the question presented is whether or not forgery was present. If the loss was effected by means of forgery, recovery is precluded by exclusion 1(a).

Nothing can be added to the previous discussion in this regard. What has already been said in support of the proposition that the instrument was not a forgery is applicable here.

CONCLUSION

Cross-appellant respectfully requests that the court reverse the judgment of the trial court and enter

judgment in its favor on any of the grounds argued in this brief.

Respectfully submitted,

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By ....
Attorneys for Cross-Appellant

CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

J. Dennis Faucher, Attorney

ACKNOWLEDGMENT OF SERVICE

The undersigned, attorneys of record for cross-appellee herein, hereby acknowledges receipt of three copies of the foregoing brief this day of ...., 1966.

CLEMONS, SKILES & GREEN

By ....
Attorneys for Cross-Appellee

APPENDIX OF EXHIBITS

Exhibit	Identified	Offered	Admitted or Rejected
Plaintiff's 1		Pre - Trial Order	
Plaintiff's 4		Pre - Trial Order	
Plaintiff's 5		Pre - Trial Order	
Defendant's 10	Vol. III, p. 38	Vol. III, p. 39	Vol. III, p. 39
Defendant's 11	Vol. III, p. 38	Vol. III, p. 39	Vol. III, p. 39
Defendant's 12	Vol. III, p. 42	Vol. III, p. 42	Vol. III, p. 48
Defendant's 13	Vol. III, p. 48	Vol. III, p. 48	Vol. III, p. 48
Defendant's 14	Vol. III, p. 48	Vol. III, p. 48	Vol. III, p. 48
Defendant's 15	Vol. III, p. 48	Vol. III, p. 48	Vol. III, p. 48
Plaintiff's 16	Vol. III, p. 47	Vol. III, p. 47	Vol. III, p. 48
Plaintiff's 17	Vol. III, p. 48	Vol. III, p. 48	Minute Entry, Nov 23, 1965 (Tr Vol. I, p. 78)

No. 21097

In the

United States Court of Appeals For the Ninth Circuit

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Appellant,

vs.

THE IDAHO FIRST NATIONAL BANK,
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vs.

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Cross-Appellee.

BRIEF OF CROSS-APPELLEE

On Appeal from the District Court of the United States for the District of Idaho, Southern Division

FILED

FEC 5 1966

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FEB 15 1967

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UNITED PACIFIC INSURANCE CO.,
Cross-Appellee.

BRIEF OF CROSS-APPELLEE

STATEMENT OF THE CASE

This is a cross appeal by the plaintiff and appellee (cross-appellant) from the decision of the District Court finding against cross-appellant on counts II and III of cross-appellant's complaint.

Counts II and II of the complaint involve only one transaction.

On February 10, 1964, a woman giving her name as Clara Perkins deposited a check (Pl. Ex. 1), which

appeared to be a cashier's check drawn on The First National Bank of San Angelo, Texas. Count II of the complaint alleges the check to have been passed through false pretenses. Count III alleges the check to have been a counterfeit instrument.

The check was drawn on The First National Bank of San Angelo, Texas, which is a bank in existence (Tr. Vol. 3, p. 37) and was transferred to that bank but was returned marked "unpaid, 2-17-64, forgery" (Tr. Vol 3, p. 38, deposition W. G. Pitzer, p. 7) and was so recorded by the cross-appellant bank (Tr. Vol. 3, p. 40)

The check was purported to be a cashiers check, signed by James C. Bolton, but apparently no person by that name had been employed by the Texas bank (Deposition W. G. Pitzer, pp. 7-8).

The trial court held that the check constituted a forgery and was excluded under the terms of the Blanket Bond, No. 24, issued by the cross-appellee to the cross-appellant bank.

The application for the Bankers Blanket Bond excluded forgery (Def. Ex. 5). The first rider to the bond which was issued (Pl. Ex. 4) September 1, 1961, by its provisions, deleted section D, relating to loss through forgery, and there was also excluded by this rider the figures and letter, "D," wherever they appear in subsections (a) and (d) of Section 1. Thus all coverage relating to forgery was deleted and excluded from the bond.

ARGUMENT

Cross-appellant contends the money obtained through the passage of the check was obtained either through

false pretenses or by the passage of a counterfeit instrument. Cross-appellee contends that the check was a forgery and excluded from the provisions of the bond.

I

FORGERY

Naturally, there is no definition of forgery in the State of Idaho except that as defined by the Idaho Statutes.

Section 18-3601 and 18-3606, Idaho Code, define what constitutes forgery and what is a forged instrument, 18-3601 provides in part:

> "18-3601—Forgery defined. Every person who, with intent to defraud another, falsely makes, alters, forges or counterfeits, any * * * bank bill, or note, post note, check draft * * * or utters, publishes, passes or attempts to pass, as true and genuine any of the above named false, altered, forged or counterfeited matters * * * with intent to prejudice, damage or defraud any person * * * is guilty of forgery." Section 18-3606 defines certain fictitious instruments as forgery.

The Supreme Court of Idaho, State vs. Allen, 53 Idaho 737, 27p 2d 482, has said:

> "* * * So that since the amendment of Section 8414, C.S., now Section 17-3706, I.C.A., any and all of the acts mentioned in Section 17-3706, as well as any and all of the acts mentioned in Section 17-3701 I.C.A., constitutes forgery."

17-3706 and 17-3701, I.C.A., are now 18-3606 and 18-3601, Idaho Code.

Then in State vs. McDermott, 52 Idaho 602, 17p 2d 343, it was said:

> "Under the Statutes (I.C.A. Section 17-3701; C.S. Section 8408) either the making or uttering, a forged instrument is a crime, there being no degrees thereof. The crime consists in doing one, or more of the acts set forth in the Statute * * * as constituting forgery * * *."

And in State vs. Baldwin, 69 Idaho 459, 208 p 2d 161, at page 164 of the Idaho Report;

> "* * * Sections 18-3601 and 18-3606, F. C. defining forgery sets forth a great many acts and means by which the crime may be committed. The commission of any one of the proscribed acts, with intent to defraud, is sufficient. * * * Further, the crime is committed by the making, altering, etc., with the necessary intent as well as by uttering, publishing, passing, etc., with intent. If the prosecution proves the commission of the offense by either of these means, it is sufficient. The State is not required to prove both, as was requested by the appellant."

COUNT II

One of the elements of the commission of forgery is the intent to defraud.

Plaintiff apparently recognized the element of forgery present here, and that the bond does not afford coverage as to forged instruments. Thus in Count II, plaintiff attempts to allege that this check was passed by means of false pretenses. Such allegation apparently being for the purpose of escaping the forgery exclusion. Such conclusion may be drawn from the alle-

gations of Count IV which alleged the check to be a forgery.

But there is a false pretense present in the uttering or passing or attempting to pass any instrument the result of which constitutes forgery. Actually there cannot be a forgery without a false pretense.

In the instant case we have the making of a false check or the passing of a false check. It is forgery notwithstanding that some pretense was also present at the same time which pretense was false. In People's Bank and Trust Company vs. Fidelity and Gas Company, 231NC510, 57SE 2d 809, 15 ALR 2d 996, the court commented upon the evidence and said that the facts might constitute either forgery or false pretense, but that under a policy excluding forgery there was no coverage. If it was forgery, it made no difference that it might also constitute false pretenses. The court said:

> "We are not concerned here with the niceties which might be observed by the solicitor in choosing the subject of prosecution, — whether false pretense or forgery. We are convinced that if the culpable Langley had been tried and convicted of either offense the State would be estopped under the principle of former jeopardy of trying him again upon the other, since either crime must be predicated upon the same transactions. State v. Bell, 205 NC 225, 171 SE 50. And we may observe, too, in that connection, that in a long series of transactions occurring during the four months Langley of Nash Street dealt with the account of Langley of R.F.D., forgery may have been aided by parol false pretense. Under a policy which expressly rejects liability for any loss effected directly or indirectly by forgery *it makes no*

difference which was the crime and which the adulterant. The policy only covers the listed losses, not loss in general, and a clause which in plain terms rejects, in what must be considered the body of the instrument loss which is effected directly or indirectly by forgery, is not an exception from a general coverage, leaving the burden on the defendant to bring itself within it.

It appears from the evidence that loss by forgery was deleted from the instrument, because such a coverage would have to be paid for by a higher premium, in language which does not constitute a prima facie covering.

Thus no relief can be granted under Count II.

II

COUNTERFEITING

Cross-appellant then contends that if the passage of the check does not constitute false pretenses under the terms of the bond, it is loss occurred through a counterfeit instrument, and covered under the provisions of insuring clause (E).

Insuring Clause (E), in addition to the rider excluding Clause (D) (forgery) contains the following exclusion:

"* * * EXCLUDING, HOWEVER, any loss through forgery or operation of, on or in any checks, drafts, acceptances, withdrawal orders, or receipts for the withdrawal of funds or property, certificates of deposit, letters of credit, warrants, money orders or orders upon public treasurers; and excluding,

further, any loss specified in subdivisions (1) and (2) of insuring clause (D) as printed in this bond, whether or not any amount of insurance is applicable under this bond to insuring clause (D)."

Thus whether clause (D) is in effect or not, forgery is excluded from insuring clause (E).

But insuring clause (E) comes under the heading "Securities." "Securities" as commonly known under our statutes come under what is generally known as the Blue Sky Laws. It comprises stocks, bonds and the like which are also generally referred to as investments.

In 47 Am. Jur., Securities, Section 16, page 574-575, it is said:

"The term 'securities' as used in securities acts, is frequently defined in the act itself. As to the scope and application of so-called 'Blue Sky Laws' with respect to instruments not covered by express statutory definition, it has been said that to lay down a hard and fast rule by which to determine whether that which is offered to a prospective investor is such a security as may not be sold without registrations or official sanction * * * There is likewise no hard and fast rule as to what constitutes a "security" within the meaning of that term as used in the Federal Securities Act of 1933, * * * The following have been held to be within the operation of the statute: a participation trust certificate in producing oil royalties * * * so-called time trust certificates; 'shareholders receipts,' and various other contracts and instruments in the nature of profit sharing agreements. The Federal Securities Act of 1933 applies to issues of securities by a foreign government,

as well as to private securities."

And although we think that "Securities" under insuring clause (E) is something entirely different than the instrument involved here in this case, clause (E) itself clearly excludes coverage as to this type of instrument as clause (E) itself as above quoted *provides:*

> "* * * excluding, however, any loss through forgery or alteration of, on or in *any checks* * * * and excluding, further, any loss specified in subdivisions (1) and (2) of insuring clause (D) * * *"

On the other hand, counterfeiting is generally appiled to imitation of money, or governmental coins or other governmental obligations. Black's Law Dictionary, 4th Ed. (1951) defines

> "COUNTERFEIT. In Criminal Law, To forge; to copy or imitate, without authority or right, and with a view to deceive or defraud, by passing the copy or thing forged for that which is original or genuine. Most commonly applied to the fraudulent and criminal imitation of money.
> (citing authority)."

While Sections 18-3601 and 18-3606, Idaho Code, above quoted to some extent treat forgery, counterfeit and fictitious as one and the same, and prescribe the penalty for each to be forgery, the statutes also treat counterfeiting as relating to money. Thus Section 18-3607, Idaho Code provides:

> "18-3607. COUNTERFEITING COIN OR BULLION. — Every person who counterfeits any of the species of gold or silver coin current in this state, or any kind of species of gold dust, gold or silver bullion, or bars, lumps, pieces, or nuggets, or who sells,

passes, or gives in payment such counterfeit coin, dust, bullion, bars, lumps, pieces, or nuggets, or permits, causes or procures the same to be sold, uttered or passed, with intention to defraud any person, knowing the same to be counterfeited, is guilty of counterfeiting."

Sections 18-3608 to 18-3611 then provide for punishment of counterfeiting, possessing counterfeiting apparatus, etc. Thus forgery and counterfeiting are treated separately.

The language of the policy should be taken according to its ordinary and accepted meaning. Although cross-appellant contends that the provisions of an insurance policy should be construed against the insurer, the terms of the policy should not be misconstrued to obtain that end.

In *Indemnity Insurance Co. v. Pioneer Valley Savings Bank*, 343 F. 2d 634, which is cited by appellee (appellee's brief, page 9) this statement is made:

> "It is true, as defendant contends that if the language of a policy is clear and unambiguous, it is the simple duty of the trial court to give effect to such contractual language in harmony with its plain and unambiguous meaning. The trial court is not clothed with the authority to make, or to revise the contract of the parties. * * *"

And also in *First National Bank of South Carolina v. Glens Falls Ins. Co.*, 304 F. 2d 866, cited by appellee (appellee's brief page 18) it is said:

> "In our judgment the limitation cannot be ignored. It is familiar law in South Carolina and else-

where that the terms of an insurance contract must be construed in favor of the insured and against the insurer where the words of the policy are ambiguous, but where there is no ambiguity a contract of insurance, like other contracts, must be construed according to the plain and ordinary meaning of its terms. * * *"

Respectfully submitted,

CLEMONS, SKILES & GREEN

By ______________________________

Attorneys for Cross-Appellee

CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

C. STANLEY SKILES, Attorney

ACKNOWLEDGMENT OF SERVICE

The undersigned, attorneys of record for cross-appellant herein, hereby acknowledges receipt of three copies of the foregoing brief this ______ day of ____ ____________________, 1966.

LANGROISE, CLARK & SULLIVAN

By ______________________________

Attorneys for Cross-Appellant

APPENDIX OF EXHIBITS

Exhibit	Identified	Offered	Admitted or Rejected
Plaintiff's 1		Pre-Trial Order	
Plaintiff's 4		Vol. 3, p. 2	Vol. 3, p. 2
Plaintiff's 5		Pre-Trial Order	

No. 21097

In the

United States Court of Appeals For the Ninth Circuit

UNITED PACIFIC INSURANCE CO.,

Appellant,

VS.

THE IDAHO FIRST NATIONAL BANK,

Appellee

THE IDAHO FIRST NATIONAL BANK,

Cross-Appellant,

VS.

UNITED PACIFIC INSURANCE CO.,

Cross-Appellee.

REPLY BRIEF OF CROSS-APPELLANT

On Appeal from the District Court of the United States for the District of Idaho, Southern Division

FILED

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FEB 15 1967

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REPLY BRIEF OF CROSS-APPELLANT

ARGUMENT

The contention of cross-appellant has been that the loss was covered by two insuring clauses—the one insuring against loss through false pretenses and the one insuring against loss through having given value upon a written instrument which was counterfeited. It is also cross-appellant's contention that the exclusions for forgery are not applicable.

In its brief the cross-appellee insurance company has contended that the forgery exclusions are applicable and that the clause insuring against loss through counterfeit instruments, insuring clause (E), does not cover this loss. It appears that these are the only remaining issues.

I. THE FORGERY EXCLUSIONS

Primary reliance is placed by the cross-appellee on two criminal statutes, and on cases which construe these statutes. The statutes, *Idaho Code* Secs. 18-3601 and 18-3606, are "catch-all" statutes. A reading of the sections discloses that an attempt was made to list as many various offenses as possible within two statutory crimes.

Not only do reason and logic dictate that such criminal statutes cannot form the basis for determining the definition of words used in an insurance policy, but case law provides a rule of law that the definition used in a criminal statute is not controlling. *Mitchell Grain & Supply Co. v. Maryland Casualty Co.*, 195 Pac. 978 108 Kan. 379 (1921); *Montana Auto Finance Corp. v. Federal Surety Co.*, 278 Pac. 116, 85 Mont. 149 (1929); *Terry v. Water Improvement Dist. No. 5*, 64 P2d 904, 179 Okla. 106 (1937); *Nugent v. Union Automobile Ins. Co.* 13 P2d 343, 140 Ore. 61 (1932); *Dexter-Horton Nat. Bank v. United States F. & G. Co.*, 270 Pac. 799, 149 Wash. 343 (1928).

All of the Idaho cases cited by cross-appellee are criminal cases and are subject to the same criticism.

Reliance upon *People's Bank & Trust Co. v. Fidelity & Casualty Co.*, 57 SE2d 809, 231 N.C. 510, 15 ALR2d 996 (1950) is also misplaced. That case stands only

for the proposition that it can be forgery for a person to sign his own name with the intent that it be taken for the signature of another existing person with the same name. 57 SE2d at 815.

There is a factor in the instant situation which can be illustrated by *People's Bank & Trust Co., v. Fidelity & Casualty Co., supra.* In that case insuring clauses (D) and (E) had both been deleted by rider. The court called attention to the fact that the exclusion was for loss effected "directly or indirectly" by forgery. In the instant case that general exclusion applies to the false pretense allegation but not to the contention that coverage is afforded by (E). The exclusion in (E) is for loss "through FORGERY . . ." While cross-appellant has no idea why different wording is used in these two exclusions, the contract is written and drafted by the insurance company, so there must be a reason. It appears logical that a loss effected "directly or indirectly" by forgery might not be one "through forgery." Thus, even though some resemblance to forgery might preclude recovery under insuring clause (B), recovery might still be allowed under (E). (The preceding is argumentative only and is not a waiver of the contention that recovery should be allowed under insuring clause (B)).

II. THE EXTENT OF COVERAGE OF (E).

Cross-appellee is now arguing that insuring clause (E) is meant to only cover losses where stocks and bonds are involved.

The fact that the title of the clause is "Securities" is of no importance because a caption should never of itself be taken to override the intention of the parties

to an insurance policy as shown by the provisions and clauses inserted under it. *National Indemnity Company v. Giampapa*, 399 P2d 81, 65 Wn2d 627 (1965); *Thompson v. State Auto. Mutual Ins. Co.*, 11 SE2d 849, 122 W.Va. 551 (1940). The clause itself covers ". . . securities, documents or other written instruments which prove to have been . . ." If any further evidence of intent is required it is supplied by the forgery exclusion provision which specifically refers to checks. If checks were not meant to come within the term "other written instruments," there would be no reason to refer specifically to them in connection with forgery.

The last argument contained in cross-appellee's brief is also refuted by the policy itself. Cross-appellee contends that counterfeiting only applies where currency and coins are involved, and therefore recovery cannot be allowed because the instrument in question was a cashier's check. The answer is that loss caused by counterfeit currency and coins is covered by another insuring clause—insuring clause (G). Therefore the counterfeiting covered by (E) is counterfeiting other than of coins and currency.

One last point can be made. In the initial brief on this cross-appeal the contention was made that insuring clause (E) distinguishes between "forged" and "counterfeited." Reliance was placed on *Fidelity Trust Co. v. American Surety Co. of New York*, 268 F2d 805 (3rd Cir. 1959). Through an error the diagram used by the court in that case appears incorrectly on page 11 of Brief of Cross-appellant. This diagram should appear as follows:

'Plaintiff is protected against loss from its having acted upon

"written instruments which prove to have been counterfeited

or forged as to the signature of any maker, drawer, issuer, endorser, assignor, lessee, transfer agent or registrar, acceptor, surety or guarantor or as to the signature of any person signing in any other capacity,

or raised

or otherwise altered

or lost

or stolen * * *"' 268 F2d at 807.

The diagram speaks for itself in supporting cross-appellant's contention.

Respectfully submitted,

J. DENNIS FAUCHER
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By ....
Attorneys for Cross-Appellant

CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

J. Dennis Faucher, Attorney

ACKNOWLEDGMENT OF SERVICE

The undersigned, attorneys of record for cross-appellee herein, hereby acknowledges receipt of three copies of the foregoing brief this day of ...., 1966.

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